FEDERAL RESERVE BANK
OF NEW YORK

AT-10824(a)
January 5, 1996

To All Depository Institutions in the Second Federal Reserve District, and Others Maintaining Sets of Board Regulations:

Enclosed is a copy of Regulation H, "Membership of State Banking Institutions in the Federal Reserve System," as revised effective January 2, 1996. The revised pamphlet supersedes the previous printing of this regulation and any subsequent amendments thereto.

These pamphlets have been punched with an additional hole so that they can be inserted into our new, two-volume, 8-1/2 x 11 size binders.

Circulars Division

Board of Governors of the Federal Reserve System

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

12 CFR 208, as amended effective January 2, 1996

Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the Federal Reserve District in which the inquiry arises.

October 1995

Contents

* See Board pamphlet "Capital Adequacy Guidelines."

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

12 CFR 208; as amended effective January 2, 1996

SUBPART A—GENERAL PROVISIONS

SECTION 208.1—Definitions

For the purpose of this part*:

(a) The term *"state bank"* means any bank or trust company incorporated under a special or general law of a state or under a general law for the District of Columbia, any mutual savings bank (unless otherwise indicated), and any Morris Plan bank or other incorporated banking institution engaged in similar business.[1]

* The words "this part" as used herein, mean Regulation H (Code of Federal Regulations, title 12, chapter II, part 208). The Board of Governors of the Federal Reserve System has delegated authority to exercise certain functions contained in this part. See the Board's "Rules Regarding Delegation of Authority" (12 CFR 265).

[1] Under the provisions of section 19 of the Federal Reserve Act, national banks and banks organized under local laws, located in a dependency or insular possession or any part of the United States outside the states of the United

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(b) The term *"mutual savings bank"* means a bank without capital stock transacting a savings bank business, the net earnings of which inure wholly to the benefit of its depositors after payment of obligations for any advances by its organizers, and in addition thereto includes any other banking institution the capital of which consists of weekly or other time deposits which are segregated from all other deposits and are regarded as capital stock for the purposes of taxation and the declaration of dividends.

(c) The term *"Board"* means the Board of Governors of the Federal Reserve System.

(d) The term *"board of directors"* means the governing board of any institution performing the usual functions of a board of directors.

(e) The term *"Federal Reserve Bank stock"* includes the deposit which may be made with a Federal Reserve Bank in lieu of a subscription for stock by a mutual savings bank which is not permitted to purchase stock in a Federal Reserve Bank, unless otherwise indicated.

(f) The terms *"capital"* and *"capital stock"* mean common stock, preferred stock and legally issued capital notes and debentures purchased by the Reconstruction Finance Corporation which may be considered capital and capital stock for purposes of membership in the Federal Reserve System under the provisions of section 9 of the Federal Reserve Act.

SECTION 208.2—Eligibility Requirements

(a) Under the terms of section 9 of the Federal Reserve Act, as amended, to be eligible for admission to membership in the Federal Reserve System:

(1) A state bank, other than a mutual savings bank, must possess capital stock and surplus which, in the judgment of the Board, are adequate in relation to the character and condition of its assets and to its existing and prospective deposit liabilities and other corporate responsibilities: *Provided,* That no bank engaged in the business of receiving deposits other than trust funds, which does not possess capital stock and surplus in an amount equal to that which would be required for the establishment of a national banking association in the place in which it is located, shall be admitted to membership unless it is, or has been, approved for deposit insurance under the Federal Deposit Insurance Act.

(2) A mutual savings bank must possess surplus and undivided profits not less than the amount of capital required for the organization of a national bank in the place where it is situated.

(b) The minimum capital required for the organization of a national bank, referred to herein before in connection with the capital required for admission to membership in the Federal Reserve System, is as follows:

	Minimum capital
If located in a city or town with a population:	
Not exceeding 6,000 inhabitants . . .	$ 50,000
Exceeding 6,000 but not exceeding 50,000 inhabitants	100,000
Exceeding 50,000 inhabitants (except as stated below)	200,000
In an outlying district of a city with a population exceeding 50,000 inhabitants; provided state law permits organization of state banks in such location with a capital of $100,000 or less	100,000

With certain exceptions not here applicable, a national bank must have surplus equal to 20 percent of its capital in order to commence business.

SECTION 208.3—Insurance of Deposits

Any state bank becoming a member of the Federal Reserve System which is engaged in the business of receiving deposits other than

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States and the District of Columbia are not required to become members of the Federal Reserve System but may, with the consent of the Board, become members of the System. However, this part 208 is applicable only to the admission of banks eligible for admission to membership under section 9 of the Federal Reserve Act and does not cover the admission of banks eligible under section 19 of the act. Any bank desiring to be admitted to the System under the provisions of section 19 should communicate with the Federal Reserve Bank with which it desires to do business.

trust funds and which is not at the time an insured bank under the provisions of the Federal Deposit Insurance Act, will become an insured bank under the provisions of that act on the date upon which it becomes a member of the Federal Reserve System.[2] In the case of an insured bank which is admitted to membership in the Federal Reserve System, the bank will continue to be an insured bank.

SECTION 208.4—Application for Membership

(a) *State bank, other than a mutual savings bank.* A state bank, other than a mutual savings bank, applying for membership, shall make application on Form F.R. 83A to the Board for an amount of capital stock in the Federal Reserve Bank of its district equal to 6 percent of the paid-up capital stock and surplus of the applying institution.

(b) *Mutual savings bank.* A mutual savings bank applying for membership shall make application on Form F.R. 83B to the Board for an amount of capital stock in the Federal Reserve Bank of its District equal to six-tenths of 1 percent of its total deposit liabilities as shown by the most recent report of examination of such institution preceding its admission to membership, or, if such institution be not permitted by the laws under which it was organized to purchase stock in a Federal Reserve Bank, on Form F.R. 83C, for permission to deposit with the Federal Reserve Bank an amount equal to the amount which it would have been required to pay in on account of a subscription to capital stock.

(c) *Mutual savings bank which is not authorized to purchase stock of Federal Reserve Bank at time of admission.* If a mutual savings bank be admitted to membership on the basis of a deposit of the required amount with the Federal Reserve Bank in lieu of payment upon capital stock because the laws under which such bank was organized do not at that time authorize it to purchase stock in the Federal Reserve Bank, it shall subscribe on Form F.R. 83D for the appropriate amount of stock in the Federal Reserve Bank whenever such laws are amended so as to authorize it to purchase stock in a Federal Reserve Bank.[3]

(d) *Execution and filing of application.* Each application made under the provisions of this section and the exhibits referred to in the application blank shall be executed and filed, in duplicate, with the Federal Reserve Bank of the District in which the applying bank is located.

SECTION 208.5—Approval of Application

(a) *Matters given special consideration by Board.* In passing upon an application, the following matters will be given special consideration:

(1) The financial history and condition of the applying bank and the general character of its management;

(2) The adequacy of its capital structure in relation to the character and condition of its assets and to its existing and prospective deposit liabilities and other corporate responsibilities; and its future earnings prospects;

(3) The convenience and needs of the community to be served by the bank; and

(4) Whether its corporate powers are consistent with the purposes of the Federal Reserve Act.

[2] In the case of a state bank which is engaged in the business of receiving deposits other than trust funds and which at the time of its admission to membership in the Federal Reserve System is not an insured bank, the Board is required under the provisions of sections 4 and 6 of the Federal Deposit Insurance Act to issue a certificate to the Federal Deposit Insurance Corporation to the effect that the bank is a member of the Federal Reserve System and that consideration has been given to the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of the Federal Deposit Insurance Act.

[3] The Federal Reserve Act provides that, if the laws under which any such savings bank was organized be not amended at the first session of the legislature following the admission of the savings bank to membership so as to authorize mutual savings banks to purchase Federal Reserve Bank stock, or if such laws be so amended and the bank fails within six months thereafter to purchase such stock, all of its rights and privileges as a member bank shall be forfeited and its membership in the Federal Reserve System shall be terminated in the manner prescribed in section 9 of the Federal Reserve Act.

(b) *Procedure for admission to membership after approval of application.* If an applying bank conforms to all the requirements of the Federal Reserve Act and this part and is otherwise qualified for membership, its application will be approved subject to such conditions as may be prescribed pursuant to the provisions of the Federal Reserve Act. When the conditions prescribed have been accepted by the applying bank, it should pay to the Federal Reserve Bank of its District one-half of the amount of its subscription and, upon receipt of advice from the Federal Reserve Bank as to the required amount, one-half of 1 percent of its paid-up subscription for each month from the period of the last dividend.[4] The remaining half of the bank's subscription shall be subject to call when deemed necessary by the Board. The bank's membership in the Federal Reserve System shall become effective on the date as of which a certificate of stock of the Federal Reserve Bank is issued to it pursuant to its application for membership or, in the case of a mutual savings bank which is not authorized to subscribe for stock, on the date as of which a certificate representing the acceptance of a deposit with the Federal Reserve Bank in place of a payment on account of a subscription to stock is issued to it pursuant to its application for membership.

SECTION 208.6—Privileges and Requirements of Membership

Every state bank while a member of the Federal Reserve System—

(a) Shall retain its full charter and statutory rights subject to the provisions of the Federal Reserve Act and other acts of Congress applicable to member state banks, to the regulations of the Board made pursuant to law, and to the conditions prescribed by the Board and agreed to by such bank prior to its admission;

(b) Shall enjoy all the privileges and observe all the requirements of the Federal Reserve Act and other acts of Congress applicable to member state banks and of the regulations of the Board made pursuant to law which are applicable to member state banks;

(c) Shall comply at all times with any and all conditions of membership prescribed by the Board in connection with the admission of such bank to membership in the Federal Reserve System; and

(d) Shall not reduce its capital stock except with the prior consent of the Board.[5]

SECTION 208.7—Conditions of Membership

(a) Pursuant to the authority contained in the first paragraph of section 9 of the Federal Reserve Act, which authorizes the Board to permit applying state banks to become members of the Federal Reserve System "subject to the provisions of this Act and to such conditions as it may prescribe pursuant thereto," the Board, except as hereinafter stated, will prescribe the following conditions of membership for each state bank hereafter applying for admission to the Federal Reserve System, and, in addition, such other conditions as may be considered necessary or advisable in the particular case:

(1) Such bank at all times shall conduct its business and exercise its powers with due regard to the safety of its depositors, and, except with the permission of the Board of Governors of the Federal Reserve System, such bank shall not cause or permit any change to be made in the general character of its business or in the scope of the corporate powers exercised by it at the time of admission to membership.[6]

[4] In the case of a mutual savings bank which is not permitted by the laws under which it was organized to purchase stock in a Federal Reserve Bank, it shall deposit with the Federal Reserve Bank an amount equal to the amount which it would have been required to pay in on account of a subscription to capital stock.

[5] This applies to capital stock of all classes and to capital notes and debentures legally issued and purchased by the Reconstruction Finance Corporation which, under the Federal Reserve Act, are considered as capital stock for purposes of membership.

[6] For many years, the Board prescribed, as standard conditions of membership, a condition which, in general, prohibited banks from engaging as a business in the sale of real estate loans to the public and certain conditions relating to the exercise of trust powers, including one which prohibited self-dealing in the investment of trust funds. The elimination of these conditions as standard conditions of membership does not reflect any change in the Board's po-

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(2) The net capital and surplus funds of such bank shall be adequate in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities.

(b) The acquisition by a member state bank of the assets of another institution through merger, consolidation, or purchase may result in a change in the general character of its business or in the scope of its corporate powers within the meaning of the condition set forth in paragraph (a)(1) of this section, and if at any time a bank subject to such condition anticipates making any such acquisition a detailed report setting forth all the facts in connection with the transaction shall be made promptly to the Federal Reserve Bank of the District in which such bank is located.

(c) If at any time, in the light of all the circumstances, the aggregate amount of a member state bank's net capital and surplus funds appears to be inadequate, the bank, within such period as shall be deemed by the Board to be reasonable for this purpose, shall increase the amount thereof to an amount which in the judgment of the Board shall be adequate in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities.

SECTION 208.8—Banking Practices

(a) *Scope.* No state member bank shall engage in practices which are unsafe or unsound or which result in a violation of law, rule, or regulation, or which violate any condition imposed by or agreements entered into with the Board. This section outlines certain of the practices in which state member banks should not engage.

(b) *Waiver.* A state member bank has the right to petition the Board to waive the conditions of section 208.8. A waiver may be granted upon a showing of good cause. The Board in its discretion may choose to limit, among other items, the scope, duration, and timing of the waiver.

(c) *Effect on other banking practices.* Nothing in this section shall be construed as restricting in any manner the Board's authority to deal with any banking practice which is deemed to be unsafe or unsound or otherwise not in accordance with law, rule, or regulation or which violates any condition imposed in writing by the Board in connection with the granting of any application or other request by a state member bank, or any written agreement entered into by such bank with the Board. Compliance with the provisions of this section shall neither relieve a state member bank of its duty to conduct all operations in a safe and sound manner nor prevent the Board from taking whatever action it deems necessary and desirable to deal with general or specific acts or practices which, although perhaps not violating the provisions of this section, are considered nevertheless to be an unsafe or unsound banking practice.

(d) *Letters of credit and acceptances.*

(1) *Definitions.* For the purpose of this paragraph, "standby letters of credit" include every letter of credit (or similar arrangement however named or designated) which represents an obligation to the beneficiary on the part of the issuer (1) to repay money borrowed by or advanced to or for the account of the account party or (2) to make payment on account of any evidence of indebtedness undertaken by the account party, or (3) to make payment on account of any default by the account party in the performance of an obligation.[6a] An "ineligible acceptance" is a time draft accepted by a bank, which does not meet the requirements for discount with a Federal Reserve Bank.

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sition as to the undesirability of the practices formerly prohibited by such conditions; and attention is called to the fact that engaging as a business in the sale of real estate loans to the public or failing to conduct trust business in accordance with the applicable state laws and sound principles of trust administration may constitute unsafe or unsound practices and violate the condition set forth in this subparagraph.

[6a] As defined, "standby letter of credit" would not include (1) commercial letters of credit and similar instruments where the issuing bank expects the beneficiary to draw upon the issuer and which do not "guaranty" payment of a money obligation or (2) a guaranty or similar obligation issued by a foreign branch in accordance with and subject to the limitations of Regulation K.

(2) *Restrictions.*

(i) A state member bank shall not issue, renew, extend, or amend a standby letter of credit (or other similar arrangement, however named or described) or make an ineligible acceptance or grant any other extension of credit if, in the aggregate, the amount of all standby letters of credit and ineligible acceptances issued, renewed, extended, or amended on or after the effective date of this amendment, when combined with other extensions of credit issued by the bank would exceed the legal limitations on loans imposed by the state (including limitations to any one customer or on aggregate extensions of credit) or exceed legal limits pertaining to loans to affiliates under federal law (12 USC 371(c)); provided that, if any state has a separate limitation on the issuance of letters of credit or acceptances which apply to a standby letter of credit or to ineligible acceptances respectively, then the separate limitation shall apply in lieu of the standard loan limitation.

(ii) No state member bank shall issue a standby letter of credit or ineligible acceptance unless the credit standing of the account party under any letter of credit, and the customer of an ineligible acceptance, is the subject of credit analysis equivalent to that applicable to a potential borrower in an ordinary loan situation.

(iii) If several banks participate in the issuance of a standby letter of credit or ineligible acceptance under a bona fide binding agreement which provides that, regardless of any event, each participant shall be liable only up to a certain percentage or certain amount of the total amount of the standby letter of credit or ineligible acceptance issued, a state member bank need only include the amount of its participation for purposes of this section; otherwise, the entire amount of the letter of credit or acceptance must be included.

(3) *Disclosure; recordkeeping.* The amount of all outstanding standby letters of credit and ineligible acceptances, regardless of when issued, shall be adequately disclosed in the bank's published financial statements.

Each state member bank shall maintain adequate control and subsidiary records of its standby letters of credit comparable to the records maintained in connection with the bank's direct loans so that at all times the bank's potential liability thereunder and the bank's compliance with this section (d) may be readily determined.

(4) *Exceptions.* A standby letter of credit is not subject to the restrictions set forth above in the following situations:

(i) prior to or at the time of issuance of the credit, the issuing bank is paid an amount equal to the bank's maximum liability under the standby letter of credit or

(ii) prior to or at the time of issuance, the bank has set aside sufficient funds in a segregated, clearly earmarked deposit account to cover the bank's maximum liability under the standby letter of credit.

(e) *Loans by state member banks in identified flood hazard areas.*

(1) *Property securing loan must be insured against flood.* No state member bank shall make, increase, extend or renew any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified by the secretary of Housing and Urban Development as an area having special flood hazards and in which flood insurance has been made available under the National Flood Insurance Act of 1968, unless the building or mobile home and any personal property securing such loan is covered for the term of the loan by flood insurance in an amount at least equal to the outstanding principal balance of the loan or to the maximum limit of coverage made available with respect to the particular type of property under the act, whichever is less. Notwithstanding the foregoing provision, flood insurance shall not be required on any state-owned property that is covered under an adequate policy of self-insurance satisfactory to the secretary of Housing and Urban Development who shall publish and periodically revise the list of states falling within the exemption provided in this paragraph.

(2) *Records of compliance.* Each state member bank shall maintain, in connection with all loans secured by improved real estate or a mobile home, sufficient records to indicate the method used by the bank to determine whether or not such loans fall within the provisions of this section 208.8(e).

(3) (i) *Notice of special flood hazards and availability of federal disaster relief assistance.* Each state member bank shall, as a condition of making, increasing, extending or renewing any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified by the secretary of Housing and Urban Development as an area having special flood hazards, mail or deliver as soon as feasible but not less than 10 days in advance of closing of the transaction (or not later than the bank's commitment, if any, if the period between commitment and closing is less than 10 days) a written notice to the borrower stating: (a) That the property securing the loan is or will be located in an area so identified, or in lieu of such notification a state member bank may obtain satisfactory written assurances from a seller or lessor stating that such seller or lessor has notified the borrower, prior to the execution of any agreement for sale or lease, that the property securing the loan is or will be located in an area so identified; and (b) whether, in the event of damage to the property caused by flooding in a federally declared disaster, federal disaster relief assistance will be available for such property. Each state member bank shall require the borrower, prior to closing, to provide the bank with a written acknowledgment that the property securing the loan is or will be located in an area so identified and that the borrower has received the above-required notice regarding federal disaster relief assistance.

(ii) *Sample notices.* A state member bank providing written notice containing the language presented in appendix A within the time limits prescribed in paragraph (a) of this section will be considered to be in compliance with the notice requirements of paragraph (a) of this section.

(4) *Required use of standard flood hazard determination form.* A state member bank shall use the standard flood hazard determination form developed by the director of the Federal Emergency Management Agency (the FEMA) (as set forth in appendix A of 44 CFR 65) when determining whether improved real estate or a mobile home offered as collateral security for a loan is located in an area identified by the director of the FEMA as having special flood hazards and in which flood insurance has been made available under the National Flood Insurance Act of 1968. The standard flood hazard determination form may be used in a printed, computerized, or electronic manner.

(f) *State member banks as transfer agents.*

(1) On or after December 1, 1975, no state member bank or any of its subsidiaries shall act as transfer agent, as defined in section 3(a)(25) of the Securities Exchange Act of 1934 ("act"), with respect to any security registered under section 12 of the act or which would be required to be registered except for the exemption from registration provided by subsection (g)(2)(B) or (g)(2)(G) of that section, unless it shall have filed a registration statement with the Board in conformity with the requirements of Form TA-1, which registration statement shall have become effective as hereinafter provided. Any registration statement filed by a state member bank or its subsidiary shall become effective on the thirtieth day after filing with the Board unless the Board takes affirmative action to accelerate, deny or postpone such registration in accordance with the provisions of section 17A(c) of the act. Such filings with the Board will constitute filings with the Securities and Exchange Commission for purposes of section 17(c)(1) of the act.

(2) If the information contained in Form TA-1 becomes inaccurate, misleading or incomplete for any reason, the bank or its subsidiary shall, within 60 calendar days thereafter, file an amendment to Form TA-1

correcting the inaccurate, misleading or incomplete information.

(3) Each registration statement on Form TA-1 or amendment thereto shall constitute a "report" or "application" within the meaning of section 17, 17A(c) and 32(a) of the act.

(g) *State member banks as registered clearing agencies.*

(1) *Requirement of notice.* Any state member bank or any of its subsidiaries that is a registered clearing agency pursuant to section 17A(b) of the Securities Exchange Act of 1934 (the "act"), which imposes any final disciplinary sanction on any participant therein, denies participation to any applicant or prohibits or limits any person in respect to access to services offered by such registered clearing agency, shall file with the Board and the appropriate regulatory agency (if other than the Board) for a participant or applicant notice thereof in the manner prescribed herein.

(2) *Notice of final disciplinary action.* Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final disciplinary action with respect to any participant shall promptly file a notice thereof with the Board in accordance with paragraph (g)(3) of this section. For the purposes of this paragraph "final disciplinary action" shall mean the imposition of any disciplinary sanction pursuant to section 17A(b)(3)(G) of the act or other action of a registered clearing agency which, after notice and opportunity for hearing, results in any final disposition of charges of:

(i) one or more violations of the rules of such registered clearing agency; or

(ii) acts or practices constituting a statutory disqualification of a type defined in subparagraph (iv) or (v) (except prior convictions) of section 3(a)(39) of the act.

However, if a registered clearing agency fee schedule specifies certain charges for errors made by its participants in giving instructions to the registered clearing agency which are de minimis on a per error basis and whose purpose is in part to provide revenues to the registered clearing agency to compensate it for effort expended in beginning to process an erroneous instruction, such error charges shall not be considered a "final disciplinary action" for purposes of this paragraph.

(3) *Content of notice required by paragraph (g)(2).* Any notice filed pursuant to paragraph (g)(2) of this section shall consist of the following, as appropriate:

(i) the name of the respondent concerned together with the respondent's last known address as reflected on the records of the registered clearing agency and the name of the person, committee, or other organizational unit that brought the charges involved; except that, as to any respondent who has been found not to have violated a provision covered by a charge, identifying information with respect to such person may be deleted insofar as the notice reports the disposition of that charge and, prior to the filing of the notice, the respondent does not request that identifying information be included in the notice.

(ii) a statement describing the investigative or other origin of the action;

(iii) as charged in the proceeding, the specific provision or provisions of the rules of the registered clearing agency violated by such person or the statutory disqualification referred to in paragraph (g)(2)(ii) of this section and a statement describing the answer of the respondent to the charges;

(iv) a statement setting forth findings of fact with respect to any act or practice in which such respondent was charged with having engaged in or omitted; the conclusion of the registered clearing agency as to whether such respondent violated any rule or was subject to a statutory disqualification as charged; and a statement of the registered clearing agency in support of its resolution of the principal issues raised in the proceedings;

(v) a statement describing any sanction imposed, the reasons therefor, and the date upon which such sanction has or will become effective; and

(vi) such other matters as the registered clearing agency may deem relevant.

(4) *Notice of final denial, prohibition, ter-*

mination or limitation based on qualification or administrative rules. Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final action which denies participation to, or conditions the participation of, any person or prohibits or limits any person with respect to access to services offered by the clearing agency based on an alleged failure of such person to—

(i) comply with the qualification standards prescribed by the rules of such registered clearing agency pursuant to section 17A(b)(4)(B) of the act; or

(ii) comply with any administrative requirements of such registered clearing agency (including failure to pay entry or other dues or fees or to file prescribed forms or reports) not involving charges of violations which may lead to a disciplinary sanction

shall not be considered a "final disciplinary action" for purposes of paragraph (g)(2) of this section, but notice thereof shall be promptly filed with the Board and the appropriate regulatory agency (if other than the Board) for the affected person in accordance with paragraph (g)(5) of this section; provided however, that no such action shall be considered "final" pursuant to this subparagraph that results merely from a notice of such failure to the person affected, if such person has not sought an adjudication of the matter, including a hearing, or otherwise exhausted his administrative remedies within the registered clearing agency with respect to such a matter.

(5) *Content of notice required by paragraph (g)(4).* Any notice filed pursuant to paragraph (g)(4) of this section shall consist of the following, as appropriate:

(i) the name of each person concerned together with each such person's last known address as reflected in the records of the registered clearing agency;

(ii) the specific grounds upon which the action of the registered clearing agency was based, and a statement describing the answer of the person concerned;

(iii) a statement setting forth findings of fact and conclusions as to each alleged failure of the person to comply with qualification standards, or comply with administrative obligations, and a statement of the registered clearing agency in support of the resolution of the principal issues raised in the proceeding;

(iv) the date upon which such action has or will become effective; and

(v) such other matters as the registered clearing agency deems relevant.

(6) *Notice of final action based upon prior adjudicated statutory disqualifications.* Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final action with respect to any person that:

(i) denies or conditions participation to any person or prohibits or limits access to service offered by such registered clearing agency; and

(ii) is based upon a statutory disqualification of a type defined in subparagraph (A), (B) or (C) of section 3(a)(39) of the act of consisting of a prior conviction as described in subparagraph (E) of said section 3(a)(39) shall promptly file notice thereof with the Board and the appropriate regulatory agency (if other than the Board) for the affected person in accordance with paragraph (g)(7) of this section; provided, however, that no such action shall be considered "final" pursuant to this subparagraph which results merely from a notice of such failure to the person affected, if such person has not sought an adjudication of the matter, including a hearing, or otherwise exhausted his administrative remedies within the registered clearing agency with respect to such a matter.

(7) *Content of notice required by paragraph (g)(6).* Any notice filed pursuant to paragraph (g)(6) of this section shall consist of the following, as appropriate:

(i) the name of the person concerned, together with each such person's last known address as reflected in the records of the registered clearing agency;

(ii) a statement setting forth the principal issues raised, the answer of any person concerned, and a statement of the registered clearing agency in support of its

resolution of the principal issues raised in the proceeding;

(iii) any description furnished by or on behalf of the person concerned of the activities engaged in by the person since the adjudication upon which the disqualification is based;

(iv) a copy of the order or decision of the court, the appropriate regulatory agency or the self-regulatory organization which adjudicated the matter giving rise to such statutory disqualification;

(v) the nature of the action taken and the date upon which such action is to be made effective; and

(vi) such other matters as the registered clearing agency deems relevant.

(8) *Notice of summary suspension of participation.* Any registered clearing agency for which the Board is the appropriate regulatory agency that summarily suspends or closes the accounts of a participant pursuant to the provisions of section 17A (b)(5)(C) of the act shall within one business day after the effectiveness of such action file notice thereof with the Board and the appropriate regulatory agency for the participant (if other than the Board) of such action in accordance with paragraph (g)(9) of this section.

(9) *Content of notice of summary suspension of participation.* Any notice pursuant to paragraph (g)(8) of this section shall contain at least the following information, as appropriate:

(i) the name of the participant concerned together with the participant's last known address as reflected in the records of the registered clearing agency;

(ii) the date upon which such summary action has or will become effective;

(iii) if such summary action is based upon the provisions of section 17A (b)(5)(C)(i) of the act, a copy of the relevant order or decision of the self-regulatory organization if available to the registered clearing agency;

(iv) if such summary action is based upon the provisions of section 17A (b)(5)(C)(ii) of the act, a statement describing the default of any delivery of funds or securities to the registered clearing agency;

(v) if such summary action is based upon the provisions of section 17A (b)(5)(C)(iii) of the act, a statement describing the financial or operating difficulty of the participant based upon which the registered clearing agency determined that such suspension and closing of accounts was necessary for the protection of the clearing agency, its participants, creditors or investors;

(vi) the nature and effective date of the suspension; and

(vii) such other matters as the registered clearing agency deems relevant.

(h) *Applications for stays of disciplinary sanctions or summary suspensions by a registered clearing agency.* If a registered clearing agency for which the Securities and Exchange Commission is not the appropriate regulatory agency imposes any final disciplinary sanction pursuant to section 17A(b)(3)(G) of the act, or summarily suspends or limits or prohibits access pursuant to section 17A(b)(5)(C) of the act, any participant aggrieved thereby for which the Board is the appropriate regulatory agency may file with the Board, by telegram or otherwise, a request for a stay of imposition of such action. Such request shall be in writing and shall include a statement as to why such stay should be granted.

(i) *Application for review of final disciplinary sanctions, denials of participation or prohibitions or limitations of access to services imposed by registered clearing agencies.*

(1) *Scope.* Proceedings on an application to the Board under section 19(d)(2) of the act by a person that is subject to the Board's jurisdiction for review of any action by a registered clearing agency for which the Securities and Exchange Commission is not the appropriate regulatory agency shall be governed by this paragraph.

(2) *Procedure.*

(i) An application for review pursuant to section 19(d)(2) of the act shall be filed with the Board within 30 days after notice is filed by the registered clearing agency pursuant to section 19(d)(1) of the act and received by the aggrieved

person applying for review, or within such longer period as the Board may determine. The secretary of the Board shall serve a copy of the application on the registered clearing agency, which shall, within 10 days after receipt of the application, certify and file with the Board one copy of the record upon which the action complained was taken, together with three copies of an index to such record. The secretary shall serve upon the parties copies of such index and any papers subsequently filed.

(ii) Within 20 days after receipt of a copy of the index, the applicant shall file a brief or other statement in support of his application which shall state the specific grounds on which the application is based, the particular findings of the registered clearing agency to which objection is taken, the relief sought. Any application not perfected by such timely brief or statement may be dismissed as abandoned.

(iii) Within 20 days after receipt of the applicant's brief or statement the registered clearing agency may file an answer thereto, and within 10 days of receipt of any such answer the applicant may file a reply. Any such papers not filed within the time provided by items (A), (B), or (C) will not be received except upon special permission of the Board.

(iv) On its own motion, the Board may direct that the record under review be supplemented with such additional evidence as it may deem relevant. Nevertheless, the registered clearing agency and persons who may be aggrieved by such clearing agency's action shall not be entitled to adduce evidence not presented in the proceedings before the registered clearing agency unless it is shown to the satisfaction of the Board that such additional evidence is material and that there were reasonable grounds for failure to present such evidence in the proceedings before the registered clearing agency. Any request for leave to adduce additional evidence shall be filed promptly so as not to delay the disposition of the proceeding.

(v) Oral argument before the Board may be requested by the applicant or the registered clearing agency as follows:

(A) by the applicant with his brief or statement or within 10 days after receipt of the registered clearing agency's answer, or

(B) by the registered clearing agency with its answer.

The Board, in its discretion, may grant or deny any request for oral argument and, where it deems it appropriate to do so, the Board will consider an application on the basis of the papers filed by the parties, without oral argument.

(vi) The Board's Rules of Practice for Formal Hearings shall apply to review proceedings under this rule to the extent that they are not inconsistent with this rule. Attention is directed particularly to section 263.21 of the Rules of Practice relating to formal requirements as to the papers filed.

(j) *State member banks, and subsidiaries, departments, and divisions thereof, which are municipal securities dealers.*

(1) For purposes of this paragraph, the terms herein have the meanings given them in section 3(a) of the Securities Exchange Act of 1934 (15 USC 78c(a)) and the rules of the Municipal Securities Rulemaking Board. The term "act" shall mean the Securities Exchange Act of 1934 (15 USC 78a et seq.).

(2) On and after October 31, 1977, a state member bank of the Federal Reserve System, or a subsidiary or a department of a division thereof, that is a municipal securities dealer shall not permit a person to be associated with it as a municipal securities principal or municipal securities representative unless it has filed with the Board an original and two copies of Form MSD-4, "Uniform Application for Municipal Securities Principal or Municipal Securities Representative Associated with a Bank Municipal Securities Dealer," completed in accordance with the instructions contained therein, for that person. Form MSD-4 is prescribed by the Board for purposes of paragraph (b) of Municipal Securities

Rulemaking Board Rule G-7, "Information Concerning Associated Persons."

(3) Whenever a municipal securities dealer receives a statement pursuant to paragraph (c) of Municipal Securities Rulemaking Board Rule G-7, "Information Concerning Associated Persons," from a person for whom it has filed a Form MSD-4 with the Board pursuant to paragraph (j)(2) of this paragraph, such dealer shall, within ten days thereafter, file three copies of that statement with the Board accompanied by an original and two copies of a transmittal letter which includes the name of the dealer and a reference to the material transmitted identifying the person involved and is signed by a municipal securities principal associated with the dealer.

(4) Within 30 days after the termination of the association of a municipal securities principal or municipal securities representative with a municipal dealer that has filed a Form MSD-4 with the Board for that person pursuant to paragraph (j)(2) of this section, such dealer shall file an original and two copies of a notification of termination with the Board on Form MSD-5, "Uniform Termination Notice for Municipal Securities Principal or Municipal Securities Representative Associated with a Bank Municipal Securities Dealer," completed in accordance with instructions contained therein.

(5) A municipal securities dealer that files a Form MSD-4, Form MSD-5, or statement with the Board under this paragraph shall retain a copy of each such Form MSD-4, Form MSD-5, or statement until at least three years after the termination of the employment or other association with such dealer of the municipal securities principal or municipal securities representative to whom the form or statement relates.

(6) The date that the Board receives a Form MSD-4, Form MSD-5, or statement filed with the Board under this paragraph shall be the date of filing. Such a Form MSD-4, Form MSD-5, or statement which is not prepared and executed in accordance with the applicable requirements may be returned as unacceptable for filing. Acceptance for filing shall not constitute any finding that a Form MSD-4, Form MSD-5, or statement has been completed in accordance with the applicable requirements or that any information reported therein is true, current, complete, or not misleading. Every Form MSD-4, Form MSD-5, or statement filed with the Board under this paragraph shall constitute a filing with the Securities and Exchange Commission for purposes of section 17(c)(1) of the act (15 USC 78q(c)(1)) and a "report," "application," or "document" within the meaning of section 32(a) of the act (15 USC 78ff(a)).

(k) *Recordkeeping and confirmation of certain securities transactions effected by state member banks.*

(1) *Definitions.* For purposes of this paragraph (k):

(i) "customer" shall mean any person or account, including any agency, trust, estate, guardianship, committee or other fiduciary account, for which a state member bank effects or participates in effecting the purchase or sale of securities, but shall not include a broker, dealer, dealer bank or issuer of the securities which are the subject of the transactions;

(ii) "collective investment fund" means funds held by a state member bank as fiduciary and, consistent with local law, invested collectively (A) in a common trust fund maintained by such bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as trustee, executor, administrator, guardian, or custodian under the Uniform Gifts to Minors Act, or (B) in a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or similar trusts which are exempt from federal income taxation under the Internal Revenue Code;

(iii) a bank shall be deemed to exercise "investment discretion" with respect to an account if, directly or indirectly, the bank (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, or (B) make decisions as to what securities or other property shall be purchased or

sold by or for the account even though some other person may have responsibility for such investment decisions.

(iv) "periodic plan" (including dividend reinvestment plans, automatic investment plans and employee stock purchase plans) means any written authorization for a state member bank acting as agent to purchase or sell for a customer a specific security or securities, in specific amounts (calculated in security units or dollars) or to the extent of dividends and funds available, at specific time intervals and setting forth the commission or charges to be paid by the customer in connection therewith or the manner of calculating them;

(v) "security" means any interest or instrument commonly known as a "security" whether in the nature of debt or equity, including any stock, bond, note, debenture, evidence of indebtedness or any participation in or right to subscribe to or purchase any of the foregoing. The term "security" does not include (A) a deposit or share account in a federally or state-insured depository institution, (B) a loan participation, (C) a letter of credit or other form of bank indebtedness incurred in the ordinary course of business, (D) currency, (E) any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, (F) units of a collective investment fund, (G) interests in a variable amount (master) note of a borrower of prime credit, or (H) U.S. Savings Bonds.

(2) *Recordkeeping.* Every state member bank effecting securities transactions for customers shall maintain the following records with respect to such transactions for at least three years:

(i) chronological records of original entry containing an itemized daily record of all purchases and sales of securities. The records of original entry shall show the account or customer for which each such transaction was effected, the description of the securities, the unit and aggregate purchase or sale price (if any), the trade date and the name or other designation of the broker-dealer or other person from whom purchased or to whom sold;

(ii) account records for each customer which shall reflect all purchases and sales of securities, all receipts and deliveries of securities, and all receipts and disbursements of cash with respect to transactions in securities for such account and all other debits and credits pertaining to transactions in securities.

(iii) a separate memorandum (order ticket) of each order to purchase or sell securities (whether executed or cancelled), which shall include:

(A) the account(s) for which the transaction was effected;

(B) whether the transaction was a market order, limit order, or subject to special instructions;

(C) the time the order was received by the trader or other bank employee responsible for effecting the transaction;

(D) the time the order was placed with the broker-dealer, or if there was no broker-dealer, the time the order was executed or cancelled;

(E) the price at which the order was executed; and

(F) the broker-dealer utilized;

(iv) a record of all broker-dealers selected by the bank to effect securities transactions and the amount of commissions paid or allocated to each such broker during the calendar year.

Nothing contained in this subparagraph shall require a bank to maintain the records required by this rule in any given manner, provided that the information required to be shown is clearly and accurately reflected and provides an adequate basis for the audit of such information.

(3) *Form of notification.* Every state member bank effecting a securities transaction for a customer shall maintain for at least three years and, except as provided in subparagraph (4), shall mail or otherwise furnish to such customer either of the following types of notifications:

(i) (A) a copy of the confirmation of a broker-dealer relating to the securities

transaction; and (B) if the bank is to receive remuneration from the customer or any other source in connection with the transaction, and the remuneration is not determined pursuant to a prior written agreement between the bank and the customer, a statement of the source and the amount of any remuneration to be received; or

(ii) a written notification disclosing:

(A) the name of the bank;

(B) the name of the customer;

(C) whether the bank is acting as agent for such customer, as agent for both such customer and some other person, as principal for its own account, or in any other capacity;

(D) the date of execution and a statement that the time of execution will be furnished within a reasonable time upon written request of such customer, and the identity, price and number of shares or units (or principal amount in the case of debt securities) of such security purchased or sold by such a customer;

(E) the amount of any remuneration received or to be received, directly or indirectly, by any broker-dealer from such customer in connection with the transaction;

(F) the amount of any remuneration received or to be received by the bank from the customer and the source and amount of any other remuneration to be received by the bank in connection with the transaction, unless remuneration is determined pursuant to a written agreement between the bank and the customer, provided, however, in the case of U.S. government securities, federal agency obligations and municipal obligations, this subparagraph (F) shall apply only with respect to remuneration received by the bank in an agency transaction; and

(G) the name of the broker-dealer utilized; or, where there is no broker-dealer, the name of the person from whom the security was purchased or to whom it was sold, or the fact that such information will be furnished within a reasonable time upon written request.

(4) *Time of notification.* The time for mailing or otherwise furnishing the written notification described in paragraph (k)(3) of this section shall be five business days from the date of the transaction, or if a broker-dealer is utilized, within five business days from the receipt by the bank of the broker-dealer's confirmation, but the bank may elect to use the following alternative procedures if the transaction is effected for:

(i) accounts (except periodic plans) where the bank does not exercise investment discretion and the bank and the customer agree in writing to a different arrangement as to the time and content of the notification; provided, however, that such agreement makes clear the customer's right to receive the written notification within the above-prescribed time period at no additional cost to the customer;

(ii) accounts (except collective investment funds) where the bank exercises investment discretion in other than an agency capacity, in which instance the bank shall, upon request of the person having the power to terminate the account or, if there is no such person, upon the request of any person holding a vested beneficial interest in such account, mail or otherwise furnish to such person the written notification within a reasonable time. The bank may charge such person a reasonable fee for providing this information.

(iii) accounts, where the bank exercises investment discretion in an agency capacity, in which instance (A) the bank shall mail or otherwise furnish to each customer not less frequently than once every three months an itemized statement which shall specify the funds and securities in the custody or possession of the bank at the end of such period and all debits, credits and transactions in the customer's accounts during such period, and (B) if requested by the customer, the bank shall mail or otherwise furnish to each such customer within a reasonable time the written notification described in

paragraph (k)(3) of this section. The bank may charge a reasonable fee for providing the information described in paragraph (k)(3) of this section.

(iv) a collective investment fund, in which instance the bank shall at least annually furnish a copy of a financial report of the fund, or provide notice that a copy of such report is available and will be furnished upon request, to each person to whom a regular periodic accounting would ordinarily be rendered with respect to each participating account. This report shall be based upon an audit made by independent public accountants or internal auditors responsible only to the board of directors of the bank.

(v) a periodic plan, in which instance the bank shall mail or otherwise furnish to the customer as promptly as possible after each transaction a written statement showing the funds and securities in the custody or possession of the bank, all service charges and commissions paid by the customer in connection with the transaction, and all other debits and credits of the customer's account involved in the transaction; provided that upon the written request of the customer the bank shall furnish the information described in subparagraph (3), except that any such information relating to remuneration paid in connection with the transaction need not be provided to the customer when paid by a source other than the customer. The bank may charge a reasonable fee for providing the information described in subparagraph (3).

(5) *Securities trading policies and procedures.* Every state member bank effecting securities transactions for customers shall establish written policies and procedures providing:

(i) assignment of responsibility for supervision of all officers or employees who (A) transmit orders to or place orders with broker-dealers, or (B) execute transactions in securities for customers;

(ii) for the fair and equitable allocation of securities and prices to accounts when orders for the same security are received at approximately the same time and are placed for execution either individually or in combination;

(iii) where applicable and where permissible under local law, for the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction; and

(iv) that bank officers and employees who make investment recommendations or decisions for the accounts of customers, who participate in the determination of such recommendations or decisions, or who, in connection with their duties, obtain information concerning which securities are being purchased or sold or recommended for such action, must report to the bank, within 10 days after the end of the calendar quarter, all transactions in securities made by them or on their behalf, either at the bank or elsewhere in which they have a beneficial interest. The report shall identify the securities purchased or sold and indicate the dates of the transactions and whether the transactions were purchases or sales. Excluded from this requirement are transactions for the benefit of the officer or employee over which the officer or employee has no direct or indirect influence or control, transactions in mutual fund shares, and all transactions involving in the aggregate $10,000 or less during the calendar quarter. For purposes of this paragraph (k)(iv), the term "securities" does not include U.S. government or federal agency obligations.

(6) *Exceptions.* The following exceptions to paragraph (k) shall apply:

(i) the requirements of subparagraph (k)(2)(ii) through (k)(2)(iv) and subparagraph (k)(5)(i) through (k)(5)(iii) shall not apply to banks having an average of less than 200 securities transactions per year for customers over the prior three-calendar-year period, exclusive of transactions in U.S. government and federal agency obligations;

(ii) activities of a state member bank that are subject to regulations promulgated by the Municipal Securities Rulemaking Board shall not be subject to the requirements of this paragraph (k); and

(iii) activities of foreign branches of a state member bank shall not be subject to the requirements of this paragraph (k).

APPENDIX A TO SECTION 208.8—Sample Notices

(1) *Notice to borrower of special flood hazards.* Notice is hereby given to _____ that the improved real estate or mobile home described in the attached instrument is or will be located in an area designated by the secretary of the Department of Housing and Urban Development as an area having special flood hazards. This area is delineated on _____'s Flood Insurance Rate Map ("FIRM") or, if the FIRM is unavailable, on the community's Flood Hazard Boundary Map ("FHBM").

This area has a 1 percent chance of being flooded within any given year. The risk of exceeding the 1 percent chance increases with time periods longer than 1 year. For example, during the life of a 30-year mortgage, a structure located in a special flood-hazardous area has a 26 percent chance of being flooded.

(2) *Notice to borrower about federal disaster relief assistance.*

(a) Notice in participating communities. The improved real estate or mobile home securing your loan is or will be located in a community that is now participating in the National Flood Insurance program. In the event such property is damaged by flooding in a federally declared disaster, federal disaster relief assistance may be available. However, such assistance will be unavailable if your community has been identified as a special flood-hazardous area for one year or longer and is not participating in the National Flood Insurance program at the time assistance would be approved. This assistance, usually in the form of a loan with a favorable interest rate, may be available for damages incurred in excess of your flood insurance.

(b) Notice in nonparticipating communities. The improved real estate or mobile home securing your loan is or will be located in a community that is not participating in the National Flood Insurance program. This means that such property is not eligible for federal flood insurance. In the event such property is damaged by flooding in a federally declared disaster, federal disaster relief assistance will be unavailable if your community has been identified as a special flood-hazardous area for one year or longer. Such assistance may be available only if at the time assistance would be approved your community is participating in the National Flood Insurance program or has been identified as a special flood-hazardous area for less than one year.

SECTION 208.9—Establishment or Maintenance of Branches

(a) *In general.* Every state bank which is or hereafter becomes a member of the Federal Reserve System is subject to the provisions of section 9 of the Federal Reserve Act relating to the establishment and maintenance of branches[7] in the United States or in a dependency or insular possession thereof or in a foreign country. Under the provisions of section 9, member state banks establishing and operating branches in the United States beyond the corporate limits of the city, town, or village in which the parent bank is situated must conform to the same terms, conditions, limitations, and restrictions as are applicable to the establishment of branches by national banks under the provisions of section 5155 of the Revised Statutes of the United States relating to the establishment of branches in the United States, except that the approval of any such branches must be obtained from the Board rather than from the Comptroller of the Currency. The approval of the Board must likewise be obtained before any member state bank establishes any branch after July 15, 1952, within the corporate limits of the city, town, or village in which the parent bank is situated (except within the District of Columbia). Under the provisions of section 9, mem-

[7] Section 5155 of the Revised Statutes of the United States provides that: "(f) The term 'branch' as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent."

ber state banks establishing and operating branches in a dependency or insular possession of the United States or in a foreign country must conform to the terms, conditions, limitations, and restrictions contained in section 25 of the Federal Reserve Act relating to the establishment by national banks of branches in such places.

(b) *Branches in the United States.*

(1) Before a member state bank establishes a branch (except within the District of Columbia), it must obtain the approval of the Board.

(2) Before any nonmember state bank having a branch or branches established after February 25, 1927, beyond the corporate limits of the city, town, or village in which the bank is situated is admitted to membership in the Federal Reserve System, it must obtain the approval of the Board for the retention of such branches.

(3) A member state bank located in a state which by statute law permits the maintenance of branches within county or greater limits may, with the approval of the Board, establish and operate, without regard to the capital requirements of section 5155 of the Revised Statutes, a seasonal agency in any resort community within the limits of the county in which the main office of such bank is located for the purpose of receiving and paying out deposits, issuing and cashing checks and drafts, and doing business incident thereto, if no bank is located and doing business in the place where the proposed agency is to be located; and any permit issued for the establishment of such an agency shall be revoked upon the opening of a state or national bank in the community where the agency is located.

(4) Except as stated in paragraph (b)(3) of this section, in order for a member state bank to establish a branch beyond the corporate limits of the city, town, or village in which it is situated, the aggregate capital stock of the member state bank and its branches shall at no time be less than the aggregate minimum capital stock required by law for the establishment of an equal number of national banking associations situated in the various places where such member state bank and its branches are situated.[8]

(5) A member state bank may not establish a branch beyond the corporate limits of the city, town, or village in which it is situated unless such establishment and operation are at the time authorized to state banks by the statute law of the state in question by language specifically granting such authority affirmatively and not merely by implication or recognition.

(6) Any member state bank which, on February 25, 1927, had established and was actually operating a branch or branches in conformity with the state law is permitted to retain and operate the same while remaining a member of the Federal Reserve System, regardless of the location of such branch or branches.

(7) The removal of a branch of a member state bank from one town to another town constitutes the establishment of a branch in such other town and, accordingly, requires the approval of the Board. The removal of a branch of a member state bank from one location in a town to another location in the same town will require the approval of the Board if the circumstances of the removal are such that the effect thereof is to constitute the establishment of a new branch as distinguished from the mere relocation of an existing branch in the immediate neighborhood without affecting the nature of its business or customers served.

(c) *Application for approval of branches in United States.* Any member state bank desiring to establish a branch should submit a request for the approval by the Board of any such branch to the Federal Reserve Bank of the district in which the bank is located. Any nonmember state bank applying for membership and desiring to retain any branch established after February 25, 1927, beyond the

[8] The requirement of this paragraph is met if the aggregate capital stock of a member state bank having branches is not less than the total amount of capital stock which would be required for the establishment of one national bank in each of the places in which the head office and branches of the member state bank are located, irrespective of the number of offices which the bank may have in any such place. There are no additional capital requirements for additional branches within the city, town, or village in which the head office is located.

corporate limits of the city, town, or village in which the bank is situated should submit a similar request. Any such request should be accompanied by advice as to the scope of the functions and the character of the business which are or will be performed by the branch and detailed information regarding the policy followed or proposed to be followed with reference to supervision of the branch by the head office; and the bank may be required in any case to furnish additional information which will be helpful to the Board in determining whether to approve such request.

(d) *Foreign branches.* With prior Board approval, a member state bank having capital and surplus of $1,000,000 or more may establish branches in "foreign countries", as defined in section 211.2(f) of Regulation K (12 CFR 211.2(f)). If a member state bank has established a branch in such a country, it may, unless otherwise advised by the Board, establish other branches therein after 30 days' notice to the Board with respect to each such branch.

(e) *Application for approval of foreign branches.* Any member state bank desiring to establish such a branch and any nonmember state bank applying for membership and desiring to retain any such branch established after February 25, 1927, should submit a request for the approval by the Board of any such branch to the Federal Reserve Bank of the District in which the bank is located. Any such request should be accompanied by advice as to the scope of the functions and the character of the business which are or will be performed by the branch and detailed information regarding the policy followed or proposed to be followed with reference to supervision of the branch by the head office; and the bank may be required in any case to furnish additional information which will be helpful to the Board in determining whether to approve such request.

SECTION 208.10—Waiver of Reports of Affiliates

Pursuant to section 21 of the Federal Reserve Act (12 USC 486), the Board of Governors of the Federal Reserve System waives the requirement for the submission of reports of affiliates of state bank members of the Federal Reserve System, unless such reports are specifically requested by the Board of Governors. The Board of Governors of the Federal Reserve System may require the submission of reports which are necessary to disclose fully relations between member banks and their affiliates and the effect thereof upon the affairs of member banks.

SECTION 208.11—Voluntary Withdrawal from Federal Reserve System

(a) *General.* Any state bank desiring to withdraw from membership in a Federal Reserve Bank may do so after six months' written notice has been filed with the Board;[9] and the Board, in its discretion, may waive such six months' notice in any individual case and may permit such bank to withdraw from membership in a Federal Reserve Bank, subject to such conditions as the Board may prescribe, prior to the expiration of six months from the date of the written notice of its intention to withdraw.

(b) *Notice of intention of withdrawal.*

(1) Any state bank desiring to withdraw from membership in a Federal Reserve Bank should signify its intention to do so, with the reasons therefor, in a letter addressed to the Board and mailed to the Federal Reserve Bank of which such bank is a member. Any such bank desiring to withdraw from membership prior to the expiration of six months from the date of written notice of its intention to withdraw should so state in the letter signifying its intention to withdraw and should state the reason for its desire to withdraw prior to the expiration of six months.

(2) Every notice of intention of a bank to

[9] Under specific provisions of section 9 of the Federal Reserve Act, however, no Federal Reserve Bank shall, except upon express authority of the Board, cancel within the same calendar year more than 25 percent of its capital stock for the purpose of effecting voluntary withdrawals during that year. All applications for voluntary withdrawals are required by the law to be dealt with in the order in which they are filed with the Board.

withdraw from membership in the Federal Reserve System and every application for the waiver of such notice should be accompanied by a certified copy of a resolution duly adopted by the board of directors of such bank authorizing the withdrawal of such bank from membership in the Federal Reserve System and authorizing a certain officer or certain officers of such bank to file such notice or application, to surrender for cancellation the Federal Reserve Bank stock held by such bank, to receive and receipt for any moneys or other property due to such bank from the Federal Reserve Bank and to do such other things as may be necessary to effect the withdrawal of such bank from membership in the Federal Reserve System.

(3) Notice of intention to withdraw or application for waiver of six months' notice of intention to withdraw by any bank which is in the hands of a conservator or other state official acting in a capacity similar to that of a conservator should be accompanied by advice from the conservator or other such state official that he joins in such notice or application.

(c) *Time and method of effecting actual withdrawal.* Upon the expiration of six months after notice of intention to withdraw or upon the waiving of such six months' notice by the Board, such bank may surrender its stock and its certificate of membership to the Federal Reserve Bank and request that same be canceled and that all amounts due to it from the Federal Reserve Bank be refunded.[10] Unless withdrawal is thus effected within eight months after notice of intention to withdraw is first given, or unless the bank requests and the Board grants an extension of time, such bank will be presumed to have abandoned its intention of withdrawing from membership and will not be permitted to withdraw without again giving six months' written notice or obtaining the waiver of such notice.

(d) *Withdrawal of notice.* Any bank which has given notice of its intention to withdraw from membership in a Federal Reserve Bank may withdraw such notice at any time before its stock has been canceled and upon doing so may remain a member of the Federal Reserve System. The notice rescinding the former notice should be accompanied by a certified copy of an appropriate resolution duly adopted by the board of directors of the bank.

SECTION 208.12—Board Forms

All forms referred to in this part and all such forms as they may be amended from time to time shall be a part of the regulations in this part.

SECTION 208.13—Capital Adequacy

The standards and guidelines by which the capital adequacy of state member banks will be evaluated by the Board are set forth in appendix A to part 208 for risk-based capital purposes, and, with respect to the ratios relating capital to total assets, in appendix B to part 208 and in appendix B to the Board's Regulation Y, 12 CFR 225.

SECTION 208.14—Procedures for Monitoring Bank Secrecy Act Compliance

(a) *Purpose.* This section is issued to ensure that all state member banks establish and maintain procedures reasonably designed to ensure and monitor their compliance with the

[10] A bank's withdrawal from membership in the Federal Reserve System is effective on the date on which the Federal Reserve Bank stock held by it is duly canceled. Until such stock has been canceled, such bank remains a member of the Federal Reserve System, is entitled to all the privileges of membership, and is required to comply with all provisions of law and all regulations of the Board pertaining to member banks and with all conditions of membership applicable to it. Upon the cancellation of such stock, all rights and privileges of such bank as a member bank shall terminate.

Upon the cancellation of such stock, and after due provision has been made for any indebtedness due or to become due to the Federal Reserve Bank, such bank shall be entitled to a refund of its cash paid subscription with interest at the rate of one-half of 1 percent per month from the date of last dividend, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise

Continued

Continued

be entitled to the repayment of deposits and of any other balance due from the Federal Reserve Bank.

provisions of subchapter II of chapter 53 of title 31, United States Code, the Bank Secrecy Act, and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR 103, requiring recordkeeping and reporting of currency transactions.[11]

(b) *Establishment of compliance program.* On or before April 27, 1987, each bank shall develop and provide for the continued administration of a program reasonably designed to ensure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code, the Bank Secrecy Act, and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103. The compliance program shall be reduced to writing, approved by the board of directors, and noted in the minutes.

(c) *Contents of compliance program.* The compliance program shall, at a minimum—

(1) provide for a system of internal controls to ensure ongoing compliance;

(2) provide for independent testing for compliance to be conducted by bank personnel or by an outside party;

(3) designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and

(4) provide training for appropriate personnel.

SECTION 208.15—Agricultural Loan Loss Amortization*

(a) *Definitions.* For purposes of this section—

(1) "Agricultural bank" means a bank—

(i) the deposits of which are insured by the Federal Deposit Insurance Corporation;

(ii) which is located in an area of the country the economy of which is dependent on agriculture;

(iii) which has total assets of $100,000,000 or less as of the most recent Report of Condition; and

(iv) which has—

(A) at least 25 percent of its total loans in qualified agricultural loans and agriculturally related other property; or

(B) less than 25 percent of its total loans in qualified agricultural loans and agriculturally related other property, but which bank the Board or the Reserve Bank in whose District the bank is located or its primary state regulator has recommended to the Federal Deposit Insurance Corporation for eligibility under this part.

(2) "Qualified agricultural loan" means—

(i) loans qualifying as "loans to finance agricultural production and other loans to farmers" or as "loans secured by farm land" for purposes of Schedule RC-C of the FFIEC Consolidated Report of Condition or such other comparable schedule;

(ii) loans secured by farm machinery;

(iii) other loans that a bank proves to be sufficiently related to agriculture for classification as an agricultural loan by the Federal Reserve; and in whose District the bank is located; and

(iv) the remaining unpaid balance of any loans, described in (i), (ii), and (iii), that have been charged off since January 1, 1984, and that qualify for deferral under this section.

(3) "Accepting official" means—

(i) the Reserve Bank in whose District the bank is located; or

(ii) the director of the Division of Banking Supervision and Regulation in cases in which the Reserve Bank cannot determine that the bank qualifies under the regulation.

(4) "Agriculturally related other property" means any property, real or personal, that the bank owned on January 1, 1983, and any such additional property that it acquires prior to January 1, 1992, in connection with a qualified agricultural loan. For the purposes of sections 208.15(a)(1)(iv) and 208.15(e), the value of such property shall include the amount previously charged off as loss.

[11] Recordkeeping requirements contained in this section have been approved by the Board under delegated authority from the Office of Management and Budget under the provisions of chapter 35 of title 44, United States Code, and have been assigned OMB No. 7100–0196.

* See Federal Deposit Insurance Act section 13(j), the statutory authority for this section.

(b) *Loss amortization and reappraisal.*

(1) Provided that there is no evidence that the loss resulted from fraud or criminal abuse on the part of the bank, its officers, directors, or principal shareholders, a bank that has been accepted under this section may, in the manner described below, amortize in its Reports of Condition and Income—

(i) Any loss that the bank would be required to reflect in its financial statements for any period between and including 1984 and 1991.

(ii) Any loss that the bank would be required to reflect in its financial statements for any period between and including 1983 and 1991 resulting from a reappraisal or sale of agriculturally related other property.

(2) Amortization under this section shall be computed over a period not to exceed seven years on a quarterly straight-line basis commencing in the first quarter after the loan was or is charged off so as to be fully amortized not later than December 31, 1998.

(c) *Accounting for amortization.* Any bank which is permitted to amortize losses in accordance with paragraph (b), above, may restate its capital and other relevant accounts and account for future authorized deferrals and amortizations in accordance with the instructions to the FFIEC Consolidated Reports of Condition and Income. Any resulting increase in the capital account shall be included in primary capital as per section 208.13 of this part.

(d) *Eligibility.* A proposal submitted in accord with paragraph (f) shall be accepted, subject to the conditions described in paragraph (e), if the accepting official finds—

(1) the proposing bank is an agricultural bank;

(2) the proposing bank's current capital is in need of restoration, but the bank remains an economically viable, fundamentally sound institution;

(3) there is no evidence that fraud or criminal abuse by the bank or its officers, directors, or principal shareholders led to significant losses on qualified agricultural loans or from a reappraisal or sale of agriculturally related other property;

(4) the proposing bank has submitted a capital plan approved by the accepting official that will restore its capital to an acceptable level.

(e) *Conditions on acceptance.* All acceptances of proposals shall be subject to the following conditions:

(1) the bank shall fully adhere to the approved capital plan and shall obtain the prior approval of the accepting official for any modifications to the plan;

(2) with respect to each asset subject to loss deferral under the program, the bank shall maintain accounting records adequate to document the amount and timing of the deferrals, repayments and amortizations;

(3) the financial condition of the bank shall not deteriorate to the point where it is no longer a viable, fundamentally sound institution;

(4) the bank agrees to make a reasonable effort, consistent with safe and sound banking practices, to maintain in its loan portfolio a percentage of agricultural loans, including agriculturally related other property, not lower than the percentage of such loans in its loan portfolio on January 1, 1986; and

(5) the bank shall agree to provide the accepting official, upon request, with such information as the accepting official deems necessary to monitor the bank's amortization, its compliance with conditions, and its continued eligibility.

(f) *Submission of proposals.*

(1) A bank wishing to amortize losses on qualified agricultural loans or from reappraisal or sale of agriculturally related other property shall submit a proposal to the appropriate accepting official.

(2) The proposal shall contain the following information:

(i) name and address of the bank;

(ii) information establishing that the bank is located in an area the economy of which is dependent on agriculture; the information could consist of a description of the bank's location, dominant lines of commerce in its service area, and any other information the bank believes will support the contention that it is located in such an area.

(iii) a copy of the bank's most recent Report of Condition and Income;

(iv) if the Report of Condition and Income fails to show that at least 25 percent of the bank's total loans are qualified agricultural loans, the basis upon which the bank believes that it should be declared eligible to amortize losses;

(v) a capital plan demonstrating that the bank will achieve an acceptable capital level not later than the end of the bank's amortization period. The plan should provide for a realistic improvement in the bank's capital, over the course of the amortization period, from earnings retention, capital injections, or other sources; and include specific information regarding dividend levels, compensation to directors, executive officers and individuals who have a controlling interest and in turn to their related interests, and payments for services or products furnished by affiliated companies.

(vi) a list of the loans and agriculturally related other property upon which the bank proposes to defer loss, including for each such loan or property the following information:

(A) the name of the borrower, the amount of the loan that resulted in the loss, and the amount of the loss;

(B) the date on which the loss was declared;

(C) the basis upon which the loss resulted from a qualified agricultural loan;

(vii) a certification by the bank's chief executive officer that there is no evidence that the losses resulted from fraud or criminal abuse by the bank, its officers, directors, or principal shareholders;

(viii) a copy of a resolution by the bank's Board of Directors authorizing submission of the proposal; and

(ix) such other information as the accepting official may require.

(g) *Revocation of eligibility.* The failure to comply with any condition in an acceptance or with the capital-restoration plan is grounds for revocation of acceptance for loss amortization and for an administrative action against the bank under 12 USC 1818(b). Additionally, acceptance of a bank for loss amortization will not foreclose any administrative action against the bank that the Board may deem appropriate.

SECTION 208.16—Reporting Requirements for State Member Banks Subject to the Securities Exchange Act of 1934

(a) *Filing requirements.* Except as otherwise provided in this section, a state member bank the securities of which are subject to registration pursuant to section 12(b) or section 12(g) of the Securities Exchange Act of 1934 (the "1934 act") (15 USC 78*l*(b) and (g)) shall comply with the rules, regulations and forms adopted by the Securities and Exchange Commission ("Commission") pursuant to sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the 1934 Act (15 USC 78*l*, 78m, 78n(a), (c), (d), (f) and 78p). The term "Commission" as used in those rules and regulations shall with respect to securities issued by state member banks be deemed to refer to the Board unless the context otherwise requires.

(b) *Elections permitted of state member banks with total assets of $150 million or less.*

(1) Notwithstanding paragraph (a) of this section or the rules and regulations promulgated by the Commission pursuant to the 1934 act, a state member bank that has total assets of $150 million or less as of the end of its most recent fiscal year and no foreign offices may elect to substitute for the financial statements required by the Commission's Form 10-Q the balance sheet and income statement from the quarterly report of condition required to be filed by such bank with the Board under section 9 of the Federal Reserve Act (12 USC 324) (Federal Financial Institutions Examination Council Forms 033 or 034).

(2) A state member bank may not elect to file financial statements from its quarterly report of condition pursuant to paragraph (1) if the amounts reported for net income, total assets or total equity capital in those statements, which are prepared on the basis of federal bank regulatory reporting stan-

dards, would differ materially from such amounts reported in financial statements prepared in accordance with generally accepted accounting principles (GAAP).

(3) A state member bank qualifying for and electing to file financial statements from its quarterly report of condition pursuant to paragraph (1) in its Form 10-Q shall include earnings per share or net loss per share data prepared in accordance with GAAP and disclose any material contingencies as required by article 10 of the Commission's Regulation S-X (15 CFR 210.10-01), in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of Form 10-Q.

(c) *Filing instructions, inspection of documents, and nondisclosure of certain information filed.*

(1) All papers required to be filed with the Board pursuant to the 1934 act or regulations thereunder shall be submitted to the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Material may be filed by delivery to the Board, through the mails, or otherwise. The date on which papers are actually received by the Board shall be the date of filing thereof if all of the requirements with respect to the filing have been complied with.

(2) No filing fees specified by the Commission's rules shall be paid to the Board.

(3) Copies of the registration statement, definitive proxy solicitation materials, reports and annual reports to shareholders required by this section (exclusive of exhibits) will be available for public inspection at the Board's offices in Washington, D.C., as well as at the Federal Reserve Banks of New York, Chicago, and San Francisco and at the Reserve Bank in the District in which the reporting bank is located.

(4) Any person filing any statement, report, or document under the 1934 act may make written objection to the public disclosure of any information contained therein in accordance with the procedure set forth below:

(i) The person shall omit from the statement, report, or document, when it is filed, the portion thereof that the person desires to keep undisclosed (hereinafter called the confidential portion). The person shall indicate at the appropriate place in the statement, report, or document that the confidential portion has been so omitted and filed separately with the Board.

(ii) The person shall file with the copies of the statement, report, or document filed with the Board—

(A) as many copies of the confidential portion, each clearly marked "CONFIDENTIAL TREATMENT", as there are copies of the statement, report, or document filed with the Board. Each copy of the confidential portion shall contain the complete text of the item and, notwithstanding that the confidential portion does not constitute the whole of the answer, the entire answer thereto; except that in case the confidential portion is part of a financial statement or schedule, only the particular financial statement or schedule need be included. All copies of the confidential portion shall be in the same form as the remainder of the statement, report, or document; and

(B) an application making objection to the disclosure of the confidential portion. Such application shall be on a sheet or sheets separate from the confidential portion, and shall (1) identify the portion of the statement, report, or document that has been omitted, (2) include a statement of the grounds of objection, and (3) include the name of each exchange, if any, with which the statement, report, or document is filed. The copies of the confidential portion and the application filed in accordance with this subparagraph shall be enclosed in a separate envelope marked "CONFIDENTIAL TREATMENT" and addressed to Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

(iii) Pending the determination by the Board on the objection filed in accordance with this paragraph, the confidential portion will not be disclosed by the Board.

(iv) If the Board determines that the objection shall be sustained, a notation to that effect will be made at the appropriate place in the statement, report, or document.

(v) If the Board determines that the objection shall not be sustained because disclosure of the confidential portion is in the public interest, a finding and determination to that effect will be entered and notice of the finding and determination will be sent by registered or certified mail to the person.

(vi) If the Board determines that the objection shall not be sustained pursuant to paragraph (c)(4)(v), the confidential portion shall be made available to the public—

(A) 15 days after notice of the Board's determination not to sustain the objection has been given as required by paragraph (c)(4)(v) of this section, provided that the person filing the objection has not previously filed with the Board a written statement that he intends in good faith to seek judicial review of the finding and determination;

(B) 60 days after notice of the Board's determination not to sustain the objection has been given as required by paragraph (c)(4)(v) of this section and the person filing the objection has filed with the Board a written statement that he intends to seek judicial review of the finding and determination but has failed to file a petition for judicial review of the Board's determination; or

(C) upon final judicial determination, if adverse to the party filing the objection.

(vii) If the confidential portion is made available to the public, a copy thereof shall be attached to each copy of the statement, report, or document filed with the Board.

SECTION 208.17—Disclosure of Financial Information by State Member Banks

(a) *Purpose and scope.* The purpose of this section is to facilitate the dissemination of publicly available information regarding the financial condition of state member banks, state-licensed agencies of foreign banks, and state-licensed branches of foreign banks that are not insured by the Federal Deposit Insurance Corporation. This section requires all state-chartered banks that are members of the Federal Reserve System and all other covered institutions (1) to make year-end call reports or Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks or, in the case of state member banks, other alternative financial information, available to shareholders, customers, and the general public upon request; and (2) to advise shareholders and the public of the availability of this information.

(b) *Definitions.* For purposes of this section, the following definitions apply:

(1) "Call report" means the Consolidated Reports of Condition and Income (OMB No. 7100-0036) filed pursuant to 12 USC 324 and section 208.10 of this regulation (12 CFR 208.10).

(2) "State member bank" means a bank that is chartered by a state and is a member of the Federal Reserve System.

(3) "Other covered institutions" means state-licensed agencies of foreign banks, or state-licensed branches of foreign banks that are not insured by the Federal Deposit Insurance Corporation.

(c) *Availability of financial information.*

(1) *Shareholders.* Each state member bank shall advise its shareholders, by a written announcement, which may be included in the notice of the annual shareholders' meeting, that one copy of certain financial information is available free of charge upon request. The announcement shall include, at a minimum, an address or telephone number to which requests may be directed.

(2) *General public.* State member banks and other covered institutions shall use reasonable means at their disposal to advise

the public of the availability of information pursuant to this section. Bankers' banks, as defined by the Federal Reserve Act, as amended by the Monetary Control Act of 1980 (title I of Pub. L. 96-221), and 12 CFR 204.121, are exempt from this requirement. The notification to the public shall state that one copy of the information is available free of charge upon request and state an address or telephone number to which requests may be directed.

(d) *Financial information to be provided by state member banks.* The bank shall have discretion to determine which type of information, identified in this subsection, to release. The bank shall make the information it chooses to release available as soon as is reasonably possible but not later than April 1 of the year immediately following the end of the year to which the most recently available information pertains. State member banks shall fulfill the requirements of this section by providing, upon request, at least one free copy to each requestor of the following information:

(1) copies of their entire call report for the most recent year-end and the prior year-end, excluding any information for which confidential treatment is permitted pursuant to the call report instructions; or

(2) copies of only the following schedules from their call reports for the most recent year-end and the prior year-end, excluding any information for which confidential treatment is permitted pursuant to the call report instructions:

(i) Schedule RC (Balance Sheet);

(ii) Schedule RC-N (Past-Due and Nonaccrual Loans and Leases);

(iii) Schedule RI (Income Statement);

(iv) Schedule RI-A (Changes in Equity Capital); and

(v) Schedule RI-B (Charge-Offs and Recoveries and Changes in Allowance for Loan and Lease Losses)—Part I may be omitted; or

(3) in the case of a bank required to file statements and reports pursuant to the Board's Regulation H, a copy of the bank's annual report to shareholders for meetings at which directors are to be elected or the bank's annual report; or

(4) in the case of a bank with independently audited financial statements, copies of the audited financial statements and the certificate or report of the independent accountant if such statements contain information for the two most recent year-ends comparable to that specified in subsection (d)(2); or

(5) in the case of a bank that is the only bank subsidiary of a bank holding company, that is majority-owned by that bank holding company, and that has assets equal to 95 percent or more of the bank holding company's consolidated total assets, a copy of either (i) the annual report of the bank holding company prepared in conformity with the regulations of the Securities and Exchange Commission; or (ii) if the holding company has consolidated assets of $150 million or more, the sections in the bank holding company's consolidated financial statements for the most recent year-end and the prior year-end on Form FY-Y-9C (Consolidated Financial Statements for Bank Holding Companies with Total Consolidated Assets of $150 Million or More, or with More Than One Subsidiary Bank (OMB No. 7100-0128)) prepared pursuant to the Board's Regulation Y, and comparable to the call report schedules enumerated in paragraph (d)(2) of this section.

(e) *Financial information to be provided by other covered institutions.* Other covered institutions shall fulfill the requirements of this section by providing, upon request, at least one free copy to each requestor of the following schedules from the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (OMB No. 7100-0032) for the most recent year-end and the prior year-end:

(1) Schedule RAL (Assets and Liabilities);

(2) Schedule E (Deposit Liabilities and Credit Balances);

(3) Schedule P (Other Borrowed Money).

The institution shall make the information available as soon as is reasonably possible but not later than April 1 of the year immediately following the end of the year to which the most recently available information pertains.

(f) *Disclaimer.* The following legend shall be included with any financial information pro-

vided pursuant to this section: "This financial information has not been reviewed, or confirmed for accuracy or relevance, by the Federal Reserve System."

(g) This section is not intended to create a private right of action against any institution disclosing documents pursuant to this section.

SECTION 208.18—Appraisal Standards for Federally Related Transactions

The standards applicable to appraisals rendered in connection with federally related transactions entered into by state member banks are set forth in subpart G of the Board's Regulation Y, 12 CFR 225.

SECTION 208.19—Payment of Dividends

(a) *Capital limitations on payment of dividends.* No state member bank shall, during the time it continues its banking operations, withdraw, or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. If losses have at any time been sustained by a state member bank that equal or exceed its undivided profits then on hand, no dividend shall be paid. No dividend shall be paid by a state member bank while it continues its banking operations, to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts.

(1) *Exceptions.* Exceptions to the limitations contained in this paragraph (a) may be made only with the prior approval of the Board and of at least two-thirds of the shares of each class of stock outstanding.

(2) *Dividends on common and preferred stock.* The provisions of this paragraph (a) shall apply to the payment of dividends on both common and preferred stock.

(3) *"Bad debt."* Under paragraph (a), bad debts must be deducted from the net profits then on hand in computing funds available for the payment of dividends. The term "bad debt" includes matured obligations due a bank on which the interest is past due and unpaid for six months unless the debts are well secured and in the process of collection. Obligations include every type of indebtedness owed to the bank, including, for example, loans, investment securities, time deposits in other depository institutions, and leases. The six-month period of default may begin at any time, regardless of when the debt matures.

(i) *Matured debt.* Whether a debt has matured for the purposes of this subsection usually will be determined by applicable contract law. Generally, a debt is matured when all or a part of the principal is due and payable as a result of demand, arrival of the stated maturity date, or acceleration by contract or by operation of law. Nevertheless, any demand debt on which the payment of interest is six months past due will be considered matured even though payment on the debt has not been demanded. Installment loans on which any payment is six months past due will be considered matured even though acceleration of the total debt may not have occurred.

(ii) *Well-secured debt.* A debt is well secured if it is secured by collateral in the form of liens on, or pledges of, real or personal property, including securities, having realizable value sufficient to discharge the debt in full, or by the guaranty of a financially responsible party. If a loan that would otherwise be considered a bad debt is partially secured, that portion not properly secured will be considered a bad debt.

(iii) *Debt in process of collection.* A debt is in the process of collection if collection of the debt is proceeding in due course, either through legal action, including judgment enforcement procedures, or, in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to current status. In any case, the bank should have a plan of collection setting forth the reasons for the selected method of collection, the responsibilities of the bank and the borrower, and the expected date of repayment of the debt or its restoration to current status.

(iv) *Debts of bankrupt or deceased debtors.* A claim duly filed against the estate of a bankrupt or deceased debtor is considered as being in the process of collection. The obligation is well secured if it meets the criteria set forth in paragraph 3(a)(ii) of this section or if the claim of the bank against the estate has been duly filed and the statutory period for filing has expired and the assets of the estate are adequate to discharge all obligations in full.

(v) *Documentation.* The bank must maintain in its files documentation to support its evaluation of the obligation. In addition, the bank must retain, at a minimum, monthly progress reports on its collection efforts, noting and explaining any deviation from the collection plan.

(4) *"Undivided profits then on hand".* For the purpose of this section, the terms "undivided profits then on hand" and "net profits then on hand" shall have the same meaning, and shall be referred to herein as "undivided profits then on hand".

(i) *Allowance for loan and lease losses.* When calculating the amount of dividends a bank can pay under 12 USC 56 and this paragraph, the bank may not add the balance in its allowance for loan and lease losses to its undivided profits for the purpose of determining undivided profits then on hand. The terms "allowance for loan and lease losses" and "undivided profits" shall have the same meaning as set forth in the instructions for the Reports of Condition and Income.

(ii) *Bad debts.* When deducting its bad debts from its undivided profits then on hand, a bank shall first subtract the sum of its bad debts from the balance of its allowance for loan and lease losses account. If the sum of a bank's bad debts is greater than its allowance for loan and lease losses, the excess bad debt shall then be deducted from the bank's undivided profits then on hand.

(iii) *Surplus surplus.* State member banks are required to comply with state law provisions concerning the maintenance of surplus funds in addition to common capital. To the extent a bank has capital surplus in excess of that required under applicable state law, the bank has "surplus surplus." Only that portion of the surplus surplus that meets the following conditions may be transferred to the undivided-profits account and be available for the payment of dividends:

(A) The bank's board of directors approves the transfer of funds from capital surplus to undivided profits; and

(B) The transfer has been approved by the Board. The bank must be able to demonstrate to the Board that the portion of the surplus surplus to be transferred came from the earnings of prior periods, excluding earnings transferred as a result of stock dividends. Requests for Board approval shall be submitted to the appropriate Federal Reserve Bank. The bank may consider the transfer to be approved if the Board or the Reserve Bank does not notify the bank within 30 days after the Reserve Bank's receipt of the notice that the transfer has been disapproved or that it is subject to continuing consideration.

(b) *Earnings limitations on payment of dividends.* A state member bank may not pay a dividend if the total of all dividends declared by the bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two calendar years, less any required transfers to surplus or to a fund for the retirement of any preferred stock, unless the bank has received the prior approval of the Board for the dividend under paragraph (b)(3) of this section.

(1) *Dividends on common and preferred stock.* The provisions of this paragraph (b) apply to the payment of dividends on both preferred and common stock.

(2) *"Net profits."* "Net profits" shall be equal to the net income or loss as reported by a state member bank in its Reports of Condition and Income. When computing its "net profits" under this section, a bank should not add its provisions for loan and lease losses to, nor deduct net charge-offs from, its reported net income.

(3) *Retained net profits.* Retained net profits

of any period shall be equal to the net income or loss as reported in the Reports of Condition and Income less any common or preferred stock dividends declared or otherwise charged to the undivided profits of the period for which retained net profits are computed.

(4) *Approval of dividends.* A bank must request and receive the approval of the Board before declaring a dividend if the amount of all dividends (common and preferred), including the proposed dividend, declared by the bank in any calendar year exceeds the total of the bank's net profits of that year to date combined with its retained net profits of the preceding two calendar years, less any required transfers to surplus or a fund for the retirement of any preferred stock. Requests for the Board's approval shall be submitted to the appropriate Federal Reserve Bank.

(5) *Effective date and transition provisions.*

(i) For the purpose of computing "net profits" pursuant to 12 USC 60, a state member bank must apply paragraph (b)(2) of this section no later than January 1, 1991. A bank may elect to use this paragraph (b)(2) of this section to calculate net profits for 1990, if it applies this provision on a full calendar year to date basis.

(ii) Whether a bank chooses to use paragraph (b)(2) of this section beginning as of January 1, 1990 or 1991, it may elect to apply the paragraph (b)(2) to recalculate retained net profits for one or both of the prior two years.

(iii) Once a bank has elected to calculate net profits or retained net profits for a particular year applying the provisions of paragraph (b)(2) of this section, retained net profits and net profits for all subsequent periods in the calculation must also be calculated using paragraph (b)(2) of this section. If a state member bank has elected to use paragraph (b)(2) of this section for a particular year, the bank may not change the method of calculation used for that year during subsequent periods.

SECTION 208.20—Reports of Crimes and Suspected Crimes

(a) *Purpose.* This section applies to known or suspected crimes involving state member banks. This section ensures that law enforcement agencies are notified by means of criminal referral reports when unexplained losses or known or suspected criminal acts are discovered. Based on these reports, the federal government will take appropriate measures and will maintain an interagency database that is derived from these reports.

(b) *Institution-affiliated party. Institution-affiliated party* means any institution-affiliated party as that term is defined in sections 3(u) and 8(b)(3) and (4) of the FDIA (12 USC 1813(u) and 1818(b)(3) and (4)).

(c) *Reports required.* A state member bank shall file a criminal referral report using a standardized form (Form),[12] in accordance with instructions for the Form, in every situation where—

(1) the state member bank suspects one of its directors, officers, employees, agents, or other institution-affiliated parties of having committed or aided in the commission of a crime;

(2) There is an actual or potential loss to the state member bank (before reimbursement or recovery) of more than $1,000 where the state member bank has a substantial basis for identifying a possible suspect or group of suspects and the suspect(s) is not a director, officer, employer, agent, or institution-affiliated party of the state member bank;

(3) there is an actual or potential loss to the state member bank (before reimbursement or recovery) of $5,000 or more and where the state member bank has no substantial basis for identifying a possible suspect or group of suspects; or

(4) the state member bank suspects that it is being used as a conduit for criminal activity, such as money laundering or structuring transactions to evade the Bank Secrecy Act reporting requirements.

[12] Copies of the Form (FR 2230) are available from the Federal Reserve Banks. The Form may be prepared using a computer shell that is distributed by the Board.

(d) *Time for reporting.*

(1) A state member bank shall file the report required by paragraph (c) of this section no later than 30 calendar days after the date of detection of the loss or the known or suspected criminal violation or activity. If no suspect has been identified within 30 calendar days after the date of the detection of the loss or the known, attempted, or suspected criminal violation or activity, reporting may be delayed an additional 30 calendar days or until a suspect has been identified; but in no case shall reporting of known or suspected crimes be delayed more than 60 calendar days after the date of the detection of the loss or the known, attempted, or suspected criminal violation or activity. When a report requirement is triggered by the identification of a suspect or group of suspects, the reporting period commences with the identification of each suspect or group of suspects.

(2) When a state member bank detects a pattern of crimes committed by an identifiable individual, the state member bank shall file a report no later than 30 calendar days after the aggregated amount of the crimes exceeds $1,000.

(3) In situations involving violations requiring immediate attention or where a reportable violation is ongoing, the state member bank shall immediately notify by telephone the appropriate law enforcement agency and the appropriate Federal Reserve Bank in addition to filing a timely written report.

(e) *Reporting to state and local authorities.* State member banks are encouraged to file copies of the Form with state and local authorities where appropriate.

(f) *Exceptions.* A state member bank need not file the Form—

(1) for those robberies and burglaries that are reported to local law enforcement authorities; and

(2) for lost, missing, counterfeit, or stolen securities if a report is filed pursuant to the reporting requirements of 17 CFR 240.17f-1.

(g) *Retention of records.* A state member bank shall maintain copies of any Form that it filed and the originals of all related documents for a period of 10 years from the date of the report.

(h) *Notification to board of directors.* The management of a state member bank shall promptly notify its board of directors of any report filed pursuant to this section.

(i) *Penalty.* Failure to file a report in accordance with the instructions on the Form and this regulation may subject the state member bank, its directors, officers, employees, agents, or other institution-affiliated parties to supervisory action.

SECTION 208.21—Community Development and Public-Welfare Investments

(a) *Definitions.*

(1) *Low- or moderate-income area* means—

(i) one or more census tracts in a metropolitan statistical area where the median family income adjusted for family size in each census tract is less than 80 percent of the median family income adjusted for family size of the metropolitan statistical area; or

(ii) if not in a metropolitan statistical area, one or more census tracts or block-numbered areas where the median family income adjusted for family size in each census tract or block-numbered area is less than 80 percent of the median family income adjusted for family size of the state.

(2) *Low- and moderate-income persons* has the same meaning as low- and moderate-income persons as defined in 42 USC 5302(a)(20)(A).

(3) *Small business* means a business that meets the size-eligibility standards of 13 CFR 121.802(a)(2).

(b) *Investments that do not require prior Board approval.* Notwithstanding the provisions of section 5136 of the Revised Statutes (12 USC 24 (Seventh)) made applicable to state member banks by paragraph 20 of section 9 of the Federal Reserve Act (12 USC 335), a state member bank may make an in-

vestment, without prior Board approval, if the following conditions are met:

(1) The investment is in a corporation, limited partnership, or other entity—

(i) where the Board has determined that an investment in that entity or class of entities is a public-welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 USC 338a), or a community development investment under Regulation Y (12 CFR 225.25(b)(6));

(ii) where the Comptroller of the Currency has determined, by order or regulation, that an investment in that entity by a national bank is a public-welfare investment under section 5136 of the Revised Statutes (12 USC 24 (Eleventh));

(iii) where that entity is a community development financial institution as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 USC 4702(5)); or

(iv) where that entity, directly or indirectly, engages solely in or makes loans solely for the purposes of one or more of the following community development activities:

(A) investing in, developing, rehabilitating, managing, selling, or renting residential property if a majority of the units will be occupied by low- and moderate-income persons or if the property is a "qualified low-income building" as defined in section 42(c)(2) of the Internal Revenue Code (26 USC 42(c)(2));

(B) investing in, developing, rehabilitating, managing, selling, or renting nonresidential real property or other assets located in a low- or moderate-income area and targeted towards low- and moderate-income persons;

(C) investing in one or more small businesses located in a low- or moderate-income area to stimulate economic development;

(D) investing in, developing, or otherwise assisting job training or placement facilities or programs that will be targeted towards low- and moderate-income persons;

(E) investing in an entity located in a low- or moderate-income area if that entity creates long-term employment opportunities, a majority of which (based on full time equivalent positions) will be held by low- and moderate-income persons; and

(F) providing technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development;

(2) the investment is permitted by state law;

(3) the investment will not expose the state member bank to liability beyond the amount of the investment;

(4) the investment does not exceed the sum of 2 percent of the state member bank's capital stock and surplus as defined under 12 CFR 250.162;

(5) the aggregate of all such investments of the state member bank does not exceed the sum of 5 percent of its capital stock and surplus as defined under 12 CFR 250.162;

(6) the state member bank is well capitalized or adequately capitalized under section 208.33(b)(1) and (2);

(7) the state member bank received a composite CAMEL rating of 1 or 2 under the Uniform Financial Institutions Rating System as of its most recent examination and an overall rating of at least "satisfactory" as of its most recent consumer compliance examination; and

(8) the state member bank is not subject to any written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, or memorandum of understanding issued by the Board or a Federal Reserve Bank.

(c) *Notice.* Not more than 30 days after making an investment under paragraph (b) of this section, the state member bank shall advise its Federal Reserve Bank of the investment, including the amount of the investment and the identity of the entity in which the investment is made.

(d) *Investments requiring Board approval.*

(1) With prior Board approval, a state member bank may make public-welfare investments under paragraph 23 of section 9 of the Federal Reserve Act (12 USC 338a), other than those specified in paragraph (b) of this section.

(2) Requests for approval under this paragraph should include, at a minimum, the amount of the proposed investment, a description of the entity in which the investment is to be made, an explanation of why the investment is a public-welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 USC 338a), a description of the state member bank's potential liability under the proposed investment, the amount of the state member bank's aggregate outstanding public-welfare investments under paragraph 23 of section 9 of the Federal Reserve Act, and the amount of the state member bank's capital stock and surplus as defined in 12 CFR 250.162.

(3) The Board will act on a request under this paragraph within 60 calendar days after receipt of a request that meets the requirements of paragraph (d)(2) of this section, unless the Board notifies the requesting state member bank that a longer time period will be required.

(e) *Divestiture of investments.* A state member bank shall divest itself of an investment made under paragraph (b), (d), or (f) of this section to the extent that the investment exceeds the scope of, or ceases to meet, the requirements of paragraphs (b)(1) through (b)(5), or paragraph (d) of this section. The divestiture shall be made in the manner specified in 12 CFR 225.140, Regulation Y, for interests acquired by a lending subsidiary of a bank holding company or the bank holding company itself in satisfaction of a debt previously contracted.

(f) *Preexisting investments.*

(1) For ongoing investments made prior to the final rule's effective date that are covered by paragraph (b) of this section, a state member bank shall notify its Federal Reserve Bank of the investment not more than 60 days after the final rule's effective date.

(2) For other ongoing investments made prior to the final rule's effective date, a state member bank shall request Board approval not more than one year after the final rule's effective date.

SECTION 208.22—Investment in Bank Premises

(a) Under section 24A of the Federal Reserve Act, state member bank investments in bank premises or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of the bank, and loans on the security of the stock of such corporation, do not require the approval of the Board if the aggregate of all such investments and loans, together with the indebtedness incurred by any such corporation that is an affiliate of the bank (as defined in section 2 of the Banking Act of 1933, as amended, 12 USC 221a)—

(1) does not exceed the capital stock amount of the bank; or

(2) does not exceed 50 percent of the bank's tier 1 capital and the bank—

(i) is well capitalized as defined in section 208.33(b)(1) of this part;

(ii) received a composite CAMEL rating of 1 or 2 as of its most recent examination by the relevant Federal Reserve Bank or state regulatory authority; and

(iii) is not subject to any written agreement, cease-and-desist order, capital directive, or prompt-corrective-action directive issued by the Board or a Federal Reserve Bank.

SUBPART B—PROMPT CORRECTIVE ACTION

SECTION 208.30—Authority, Purpose, Scope, Other Supervisory Authority, and Disclosure of Capital Categories

(a) *Authority.* This subpart is issued by the Board of Governers of the Federal Reserve System (Board) pursuant to section 38 (section 38) of the Federal Deposit Insurance Act (FDI Act) (12 USC 1831o) as added by section 131 of the Federal Deposit Insurance

Corporation Improvement Act of 1991 (Pub. L. 102-242, 105 Stat. 2236 (1991)).

(b) *Purpose.* Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized. The principal purpose of this subpart is to define, for state member banks, the capital measures and capital levels that are used for determining the supervisory actions authorized under section 38 of the FDI Act. This subpart also establishes procedures for submission and review of capital-restoration plans and for issuance and review of directives and orders pursuant to section 38.

(c) *Scope.* This subpart implements the provisions of section 38 of the FDI Act as they apply to state member banks. Certain of these provisions also apply to officers, directors, and employees of state member banks. Other provisions apply to any company that controls a state member bank and to the affiliates of a state member bank.

(d) *Other supervisory authority.* Neither section 38 nor this subpart in any way limits the authority of the Board under any other provision of law to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the Board, including issuance of cease-and-desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(e) *Disclosure of capital categories.* The assignment of a bank under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the Board or otherwise required by law, no bank may state in any advertisement or promotional material its capital category under this subpart or that the Board or any other federal banking agency has assigned the bank to a particular capital category.

SECTION 208.31—Definitions

For purposes of this subpart, except as modified in this section or unless the context otherwise requires, the terms used have the same meanings as set forth in section 38 and section 3 of the FDI Act.

(a) (1) *Control* has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 USC 1841), and the term "controlled" shall be construed consistently with the term "control."
(2) *Exclusion for fiduciary ownership.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect thereto.
(3) *Exclusion for debts previously contracted.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate federal banking agency for up to three one-year periods.

(b) *Controlling person* means any person having control of an insured depository institution and any company controlled by that person.

(c) *Leverage ratio* means the ratio of tier 1 capital to average total consolidated assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure (appendix B).

(d) *Management fee* means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank or related overhead expenses, including payments related to supervisory, executive, managerial, or policymaking functions, other than compensation to an individual in

the individual's capacity as an officer or employee of the bank.

(e) *Risk-weighted assets* means total weighted-risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A).

(f) *Tangible equity* means the amount of core capital elements in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to part 208), plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets except mortgage-servicing rights to the extent that the Board determines that mortgage-servicing rights may be included in calculating the bank's tier 1 capital.

(g) *Tier 1 capital* means the amount of tier 1 capital as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A).

(h) *Tier 1 risk-based capital ratio* means the ratio of tier 1 capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A).

(i) *Total assets* means quarterly average total assets as reported in a bank's Report of Condition and Income ("call report"), minus intangible assets as provided in the definition of tangible equity.

(j) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted-risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A).

SECTION 208.32—Notice of Capital Category

(a) *Effective date of determination of capital category.* A state member bank shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank is notified of, or is deemed to have notice of, its capital category, pursuant to subsection (b).

(b) *Notice of capital category.* A state member bank shall be deemed to have been notified of its capital levels and its capital category as of the most recent date—

(1) a Report of Condition and Income ("call report") is required to be filed with the Board;

(2) a final report of examination is delivered to the bank; or

(3) written notice is provided by the Board to the bank of its capital category for purposes of section 38 of the FDI Act and this subpart or that the bank's capital category has changed as provided in paragraph (c) of this section or section 208.33(c) of this part.

(c) *Adjustments to reported capital levels and capital category.*

(1) *Notice of adjustment by bank.* A state member bank shall provide the Board with written notice that an adjustment to the bank's capital category may have occurred no later than 15 calendar days following the date that any material event has occurred that would cause the bank to be placed in a lower capital category from the category assigned to the bank for purposes of section 38 and this subpart on the basis of the bank's most recent call report or report of examination.

(2) *Determination by the Board to change capital category.* After receiving notice pursuant to paragraph (c)(1) of this section, the Board shall determine whether to change the capital category of the bank and shall notify the bank of the Board's determination.

SECTION 208.33—Capital Measures and Capital-Category Definitions

(a) *Capital measures.* For purposes of section 38 and this subpart, the relevant capital measures shall be—

(1) the total risk-based capital ratio;

(2) the tier 1 risk-based capital ratio; and

(3) the leverage ratio.

(b) *Capital categories.* For purposes of sec-

tion 38 and this subpart, a state member bank shall be deemed to be—

(1) "well capitalized" if the bank—

(i) has a total risk-based capital ratio of 10.0 percent or greater, and

(ii) has a tier 1 risk-based capital ratio of 6.0 percent or greater, and

(iii) has a leverage ratio of 5.0 percent or greater, and

(iv) is not subject to any written agreement, order, capital directive, or prompt-corrective-action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983, or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure;

(2) "adequately capitalized" if the bank—

(i) has a total risk-based capital ratio of 8.0 percent or greater, and

(ii) has a tier 1 risk-based capital ratio of 4.0 percent or greater, and

(iii) has—

(A) a leverage ratio of 4.0 percent or greater, or

(B) a leverage ratio of 3.0 percent or greater if the bank is rated composite 1 under the CAMEL rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth; and

(iv) does not meet the definition of a "well-capitalized" bank;

(3) "undercapitalized" if the bank—

(i) has a total risk-based capital ratio that is less than 8.0 percent, or

(ii) has a tier 1 risk-based capital ratio that is less than 4.0 percent, or

(iii) (A) except as provided in clause (B), has a leverage ratio that is less than 4.0 percent, or

(B) has a leverage ratio that is less than 3.0 percent, if the bank is rated composite 1 under the CAMEL rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth;

(4) "significantly undercapitalized" if the bank has—

(i) a total risk-based capital ratio that is less than 6.0 percent, or

(ii) a tier 1 risk-based capital ratio that is less than 3.0 percent, or

(iii) a leverage ratio that is less than 3.0 percent;

(5) "critically undercapitalized" if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Reclassification based on supervisory criteria other than capital.* The Board may reclassify a well-capitalized state member bank as adequately capitalized and may require an adequately capitalized or an undercapitalized state member bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower capital category (except that the Board may not reclassify a significantly undercapitalized bank as critically undercapitalized) (each of these actions are hereinafter referred to generally as "reclassifications") in the following circumstances:

(1) *Unsafe or unsound condition.* The Board has determined, after notice and opportunity for hearing pursuant to section 263.203 of this chapter, that the bank is in unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The Board has determined, after notice and opportunity for hearing pursuant to section 263.203 of this chapter, that, in the most recent examination of the bank, the bank received and has not corrected, a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

SECTION 208.34—Capital-Restoration Plans

(a) *Schedule for filing plan.*

(1) *In general.* A state member bank shall file a written capital-restoration plan with the appropriate Reserve Bank within 45 days of the date that the bank receives notice or is deemed to have notice that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the Board notifies the bank in writing that the plan is to be filed within a different period. An adequately capitalized bank that has been required pursuant to section 208.33(c) to comply with supervisory

actions as if the bank were undercapitalized is not required to submit a capital-restoration plan solely by virtue of the reclassification.

(2) *Additional capital-restoration plans.* Notwithstanding paragraph (a)(1) of this section, a bank that has already submitted and is operating under a capital-restoration plan approved under section 38 and this subpart is not required to submit an additional capital-restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under section 208.33(c) unless the Board notifies the bank that it must submit a new or revised capital plan. A bank that is notified that it must submit a new or revised capital-restoration plan shall file the plan in writing with the appropriate Reserve Bank within 45 days of receiving such notice, unless the Board notifies the bank in writing that the plan is to be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital-restoration plan shall be prepared in accordance with the instructions provided on the call report, unless the Board instructs otherwise. The capital-restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A bank that is required to submit a capital-restoration plan as the result of a reclassification of the bank pursuant to section 208.33(c) shall include a description of the steps the bank will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of that act by each company that controls the bank.

(c) *Review of capital-restoration plans.* Within 60 days after receiving a capital-restoration plan under this subpart, the Board shall provide written notice to the bank of whether the plan has been approved. The Board may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital plan.* If a capital-restoration plan is not approved by the Board, the bank shall submit a revised capital-restoration plan within the time specified by the Board. Upon receiving notice that its capital-restoration plan has not been approved, any undercapitalized state member bank (as defined in section 208.33(b)(3)) shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital-restoration plan submitted by the bank has been approved by the Board.

(e) *Failure to submit capital-restoration plan.* A state member bank that is undercapitalized (as defined in section 208.33(b)(3)) and that fails to submit a written capital-restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) *Failure to implement capital-restoration plan.* Any undercapitalized state member bank that fails in any material respect to implement a capital-restoration plan shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(g) *Amendment of capital plan.* A bank that has filed an approved capital-restoration plan may, after prior written notice to and approval by the Board, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank shall implement the capital-restoration plan as approved prior to the proposed amendment.

(h) *Notice to FDIC.* Within 45 days of the effective date of Board approval of a capital-restoration plan, or any amendment to a capital-restoration plan, the Board shall provide a copy of the plan or amendment to the Federal Deposit Insurance Corporation.

(i) *Performance guarantee by companies that control a bank.*

(1) *Limitation on liability.*

(i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific state member

bank that is required to submit a capital-restoration plan under this subpart shall be limited to the lesser of—

(A) an amount equal to 5.0 percent of the bank's total assets at the time the bank was notified or deemed to have notice that the bank was undercapitalized; or

(B) the amount necessary to restore the relevant capital measures of the bank to the levels required for the bank to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank initially fails to comply with a capital-restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 and this subpart shall expire after the Board notifies the bank that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital-restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital-restoration plan filed by the same bank after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a given bank shall be jointly and severally liable for the guarantee for such bank as required under section 38 and this subpart, and the Board may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a bank that is controlled by any company submits a capital-restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks that have not submitted an acceptable capital-restoration plan.

(3) *Failure to perform guarantee.* Failure by any company that controls a bank to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank shall be subject to the provisions of section 38 and this subpart that are applicable to banks that have failed in a material respect to implement a capital-restoration plan.

SECTION 208.35—Mandatory and Discretionary Supervisory Actions under Section 38

(a) *Mandatory supervisory actions.*

(1) *Provisions applicable to all banks.* All state member banks are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks.* Immediately upon receiving notice or being deemed to have notice, as provided in section 208.32 or section 208.34 of this subpart, that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act—

(i) restricting payment of capital distributions and management fees (section 38(d));

(ii) requiring that the Board monitor the condition of the bank (section 38(e)(1));

(iii) requiring submission of a capital-restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) restricting the growth of the bank's assets (section 38(e)(3)); and

(v) requiring prior approval of certain expansion proposals (section 38(e)(4)).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in section 208.32 or section 208.34 of this subpart, that the bank is significantly under-

capitalized, or critically undercapitalized, or that the bank is subject to the provisions applicable to institutions that are significantly undercapitalized because the bank failed to submit or implement in any material respect an acceptable capital-restoration plan, the bank shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) *Additional provisions applicable to critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in section 208.32 of this subpart, that the bank is critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act—

(i) restricting the activities of the bank (section 38(h)(1)); and

(ii) restricting payments on subordinated debt of the bank (section 38(h)(2)).

(b) *Discretionary supervisory actions.* In taking any action under section 38 that is within the Board's discretion to take in connection with (1) a state member bank that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; (2) an officer or director of such bank; or (3) a company that controls such bank, the Board shall follow the procedures for issuing directives under section 263.202 and 263.204 of this chapter, unless otherwise provided in section 38 or this subpart.

SUBPART C—REAL ESTATE LENDING STANDARDS

SECTION 208.51—Purpose and Scope

This subpart, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 USC 1828(o), prescribes standards for real estate lending to be used by state member banks in adopting internal real estate lending policies.

SECTION 208.52—Real Estate Lending Standards

(a) Each state bank that is a member of the Federal Reserve System shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b) (1) Real estate lending policies adopted pursuant to this section must—

(i) be consistent with safe and sound banking practices;

(ii) be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) be reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies must establish—

(i) loan portfolio diversification standards;

(ii) prudent-underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) loan administration procedures for the bank's real estate portfolio; and

(iv) documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) Each state member bank must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the federal bank and thrift supervisory agencies [appendix C]

SUBPART D—STANDARDS FOR SAFETY AND SOUNDNESS

SECTION 208.60—Standards for Safety and Soundness

The Interagency Guidelines Establishing Standards for Safety and Soundness prescribed pursuant to section 39 of the Federal Deposit Insurance Act (12 USC 1831p-1), as set forth as appendix D to this part, apply to all state member banks.

APPENDIX A—Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure

See the Board pamphlet "Capital Adequacy Guidelines."

APPENDIX B—Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure

See the Board pamphlet "Capital Adequacy Guidelines."

APPENDIX C—Interagency Guidelines for Real Estate Lending Policies

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements. [1] These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and scope of its individual operations, as well as satisfies the requirements of the regulation.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

Loan Portfolio Management Considerations

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should—

- identify the geographic areas in which the institution will consider lending;
- establish a loan portfolio–diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher-risk loans);
- identify appropriate terms and conditions by type of real estate loan;
- establish loan-origination and approval procedures, both generally and by size and type of loan;
- establish prudent underwriting standards that are clear and measurable, including loan-to-value limits that are consistent with these supervisory guidelines;
- establish review and approval procedures for exception loans, including loans with loan-to-value percentages in excess of supervisory limits;
- establish loan-administration procedures, including documentation, disbursement, collateral inspection, collection, and loan review;
- establish real estate appraisal and evaluation programs;
- require that management monitor the loan portfolio and provide timely and adequate reports to the board of directors.

The institution should consider both internal and external factors in the formulation of its loan policies and strategic plan. Factors that should be considered include—

- the size and financial condition of the institution;

[1] The agencies have adopted a uniform rule on real estate lending. See 12 CFR 365 (FDIC); 12 CFR 208, subpart C (FRB); 12 CFR 34, subpart D (OCC); and 12 CFR 563.100–101 (OTS).

- the expertise and size of the lending staff;
- the need to avoid undue concentrations of risk;
- compliance with all real estate–related laws and regulations, including the Community Reinvestment Act, antidiscrimination laws, and for savings associations, the Qualified Thrift Lender test;
- market conditions.

The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include—

- demographic indicators, including population and employment trends;
- zoning requirements;
- current and projected vacancy, construction, and absorption rates;
- current and projected lease terms, rental rates, and sales prices, including concessions;
- current and projected operating expenses for different types of projects;
- economic indicators, including trends and diversification of the lending area;
- valuation trends, including discount and direct capitalization rates.

Underwriting Standards

Prudently underwritten real estate loans should reflect all relevant credit factors, including—

- the capacity of the borrower, or income from the underlying property, to adequately service the debt;
- the value of the mortgaged property;
- the overall creditworthiness of the borrower;
- the level of equity invested in the property;
- any secondary sources of repayment;
- any additional collateral or credit enhancements (such as guarantees, mortgage insurance, or take-out commitments).

The lending policies should reflect the level of risk that is acceptable to the board of directors and provide clear and measurable underwriting standards that enable the institution's lending staff to evaluate these credit factors. The underwriting standards should address—

- the maximum loan amount by type of property;
- maximum loan maturities by type of property;
- amortization schedules;
- pricing structure for different types of real estate loans;
- loan-to-value limits by type of property.

For development and construction projects, and completed commercial properties, the policy should also establish, commensurate with the size and type of the project or property—

- requirements for feasibility studies and sensitivity and risk analyses (e.g., sensitivity of income projections to changes in economic variables such as interest rates, vacancy rates, or operating expenses);
- minimum requirements for initial investment and maintenance of hard equity by the borrower (e.g., cash or unencumbered investment in the underlying property);
- minimum standards for net worth, cash flow, and debt-service coverage of the borrower or underlying property;
- standards for the acceptability of and limits on nonamortizing loans;
- standards for the acceptability of and limits on the use of interest reserves;
- pre-leasing and pre-sale requirements for income-producing property;
- pre-sale and minimum-unit release requirements for non-income-producing property loans;
- limits on partial recourse or nonrecourse loans and requirements for guarantor support;
- requirements for takeout commitments;
- minimum covenants for loan agreements.

Loan Administration

The institution should also establish loan administration procedures for its real estate portfolio that address—

- documentation, including—
  —type and frequency of financial statements, including requirements for

verification of information provided by the borrower;
—type and frequency of collateral evaluations (appraisals and other estimates of value);
- loan closing and disbursement;
- payment processing;
- escrow administration;
- collateral administration;
- loan payoffs;
- collections and foreclosure, including—
—delinquency followup procedures;
—foreclosure timing;
—extensions and other forms of forbearance;
—acceptance of deeds in lieu of foreclosure;
- claims processing (e.g., seeking recovery on a defaulted loan covered by a government guaranty or insurance program);
- servicing and participation agreements.

Supervisory Loan-to-Value Limits

Institutions should establish their own internal loan-to-value limits for real estate loans. These internal limits should not exceed the following supervisory limits:

Loan Category	*Loan-to-Value Limit*
Raw land	65%
Land development	75%
Construction:	
Commercial, multifamily,* and other nonresidential	80%
One- to four-family residential	85%
Improved property	85%
Owner-occupied one- to four-family and home equity	**

* Multifamily construction includes condominiums and cooperatives.

** A loan-to-value limit has not been established for permanent mortgage or home-equity loans on owner-occupied, one- to four-family residential property. However, for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

The supervisory loan-to-value limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and construction of an office building), the appropriate loan-to-value limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. In situations where a loan is fully cross-collateralized by two or more properties or is secured by a collateral pool of two or more properties, the appropriate maximum loan amount under supervisory loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each property. To ensure that collateral margins remain within the supervisory limits, lenders should redetermine conformity whenever collateral substitutions are made to the collateral pool.

In establishing internal loan-to-value limits, each lender is expected to carefully consider the institution-specific and market factors listed under "Loan Portfolio Management Considerations," as well as any other relevant factors, such as the particular subcategory or type of loan. For any subcategory of loans that exhibits greater credit risk than the overall category, a lender should consider the establishment of an internal loan-to-value limit for that subcategory that is lower than the limit for the overall category.

The loan-to-value ratio is only one of several pertinent credit factors to be considered when underwriting a real estate loan. Other credit factors to be taken into account are highlighted in the "Underwriting Standards" section above. Because of these other factors, the establishment of these supervisory limits should not be interpreted to mean that loans at these levels will automatically be considered sound.

Loans in Excess of the Supervisory Loan-to-Value Limits

The agencies recognize that appropriate loan-to-value limits vary not only among categories of real estate loans but also among individual loans. Therefore, it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits, based on the support provided by other credit factors. Such

loans should be identified in the institution's records, and their aggregate amount reported at least quarterly to the institution's board of directors. (See additional reporting requirements described under "Exceptions to the General Policy.")

The aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital.[2] Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non–one- to four-family residential properties should not exceed 30 percent of total capital. An institution will come under increased supervisory scrutiny as the total of such loans approaches these levels.

In determining the aggregate amount of such loans, institutions should (a) include all loans secured by the same property if any one of those loans exceeds the supervisory loan-to-value limits; and (b) include the recourse obligation of any such loan sold with recourse. Conversely, a loan should no longer be reported to the directors as part of aggregate totals when reduction in principal or senior liens, or additional contribution of collateral or equity (e.g., improvements to the real property securing the loan), bring the loan-to-value ratio into compliance with supervisory limits.

Excluded Transactions

The agencies also recognize that there are a number of lending situations in which other factors significantly outweigh the need to apply the supervisory loan-to-value limits. These include—

- loans guaranteed or insured by the U.S. government or its agencies, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit;
- loans backed by the full faith and credit of a state government, provided that the amount of the assurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit;
- loans guaranteed or insured by a state, municipal or local government, or an agency thereof, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit, and provided that the lender has determined that the guarantor or insurer has the financial capacity and willingness to perform under the terms of the guaranty or insurance agreement;
- loans that are to be sold promptly after origination, without recourse, to a financially responsible third party;
- loans that are renewed, refinanced, or restructured without the advancement of new funds or an increase in the line of credit (except for reasonable closing costs), or loans that are renewed, refinanced, or restructured in connection with a workout situation, either with or without the advancement of new funds, where consistent with safe and sound banking practices and part of a clearly defined and well-documented program to achieve orderly liquidation of the debt, reduce risk of loss, or maximize recovery on the loan;
- loans that facilitate the sale of real estate acquired by the lender in the ordinary course of collecting a debt previously contracted in good faith;
- loans for which a lien on or interest in real property is taken as additional collateral through an abundance of caution by the lender (e.g., the institution takes a blanket lien on all or substantially all of the assets of the borrower, and the value of the real property is low relative to the aggregate value of all other collateral);
- loans, such as working-capital loans, where the lender does not rely principally on real estate as security and the extension of credit is not used to acquire, develop, or construct permanent improvements on real property;
- loans for the purpose of financing permanent improvements to real property, but not secured by the property, if such security interest is not required by prudent underwriting practice.

[2] For state member banks, the term "total capital" means "total risk-based capital" as defined in appendix A to 12 CFR 208. For insured state nonmember banks, "total capital" refers to that term as described in table I of appendix A to 12 CFR 325. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 567.5(c).

Exceptions to the General Lending Policy

Some provision should be made for the consideration of loan requests from creditworthy borrowers whose credit needs do not fit within the institution's general lending policy. An institution may provide for prudently underwritten exceptions to its lending policies, including loan-to-value limits, on a loan-by-loan basis. However, any exceptions from the supervisory loan-to-value limits should conform to the aggregate limits on such loans discussed above.

The board of directors is responsible for establishing standards for the review and approval of exception loans. Each institution should establish an appropriate internal process for the review and approval of loans that do not conform to its own internal policy standards. The approval of any such loan should be supported by a written justification that clearly sets forth all of the relevant credit factors that support the underwriting decision. The justification and approval documents for such loans should be maintained as a part of the permanent loan file. Each institution should monitor compliance with its real estate lending policy and individually report exception loans of a significant size to its board of directors.

Supervisory Review of Real Estate Lending Policies and Practices

The real estate lending policies of institutions will be evaluated by examiners during the course of their examinations to determine if the policies are consistent with safe and sound lending practices, these guidelines, and the requirements of the regulation. In evaluating the adequacy of the institution's real estate lending policies and practices, examiners will take into consideration the following factors:

- the nature and scope of the institution's real estate lending activities
- the size and financial condition of the institution
- the quality of the institution's management and internal controls
- the expertise and size of the lending and loan-administration staff
- market conditions

Lending-policy exception reports will also be reviewed by examiners during the course of their examinations to determine whether the institution's exceptions are adequately documented and appropriate in light of all of the relevant credit considerations. An excessive volume of exceptions to an institution's real estate lending policy may signal a weakening of its underwriting practices, or may suggest a need to revise the loan policy.

Definitions

For the purposes of these guidelines:

"Construction loan" means an extension of credit for the purpose of erecting or rehabilitating buildings or other structures, including any infrastructure necessary for development.

"Extension of credit" or "loan" means—

(1) the total amount of any loan, line of credit, or other legally binding lending commitment with respect to real property; and

(2) the total amount, based on the amount of consideration paid, of any loan, line of credit, or other legally binding lending commitment acquired by a lender by purchase, assignment or otherwise.

"Improved property loan" means an extension of credit secured by one of the following types of real property:

(1) farmland, ranchland or timberland committed to ongoing management and agricultural production;

(2) one- to four-family residential property that is not owner-occupied;

(3) residential property containing five or more individual dwelling units;

(4) completed commercial property; or

(5) other income-producing property that has been completed and is available for occupancy and use, except income-producing owner-occupied one- to four-family residential property.

"Land development loan" means an extension of credit for the purposes of improving unimproved real property prior to the erection of structures. The improvement of unimproved real property may include the laying or placement of sewers, water pipes, utility cables,

streets, and other infrastructure necessary for future development.

"Loan origination" means the time of inception of the obligation to extend credit (i.e., when the last event or prerequisite, controllable by the lender, occurs, causing the lender to become legally bound to fund an extension of credit).

"Loan-to-value" or "loan-to-value ratio" means the percentage or ratio that is derived at the time of loan origination by dividing an extension of credit by the total value of the property(ies) securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral that secures the extension of credit. The total amount of all senior liens on or interests in such property(ies) should be included in determining the loan-to-value ratio. When mortgage insurance or collateral is used in the calculation of the loan-to-value ratio, and such credit enhancement is later released or replaced, the loan-to-value ratio should be recalculated.

"Other acceptable collateral" means any collateral in which the lender has a perfected security interest, that has a quantifiable value, and is accepted by the lender in accordance with safe and sound lending practices. Other acceptable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral. Other acceptable collateral includes, among other items, unconditional irrevocable standby letters of credits for the benefit of the lender.

"Owner-occupied", when used in conjunction with the term "one- to four-family residential property" means that the owner of the underlying real property occupies at least one unit of the real property as a principal residence of the owner.

"Readily marketable collateral" means insured deposits, financial instruments, and bullion in which the lender has a perfected interest. Financial instruments and bullion must be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, on an auction or similarly available daily bid and ask price market. Readily marketable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral.

"Value" means an opinion or estimate, set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the agency's appraisal regulations and guidance. For loans to purchase an existing property, the term "value" means the lesser of the actual acquisition cost or the estimate of value.

"One- to four-family residential property" means property containing fewer than five individual dwelling units, including manufactured homes permanently affixed to the underlying property (when deemed to be real property under state law).

APPENDIX D—Interagency Guidelines Establishing Standards for Safety and Soundness

I. Introduction

i. Section 39 of the Federal Deposit Insurance

Act[1] (FDI Act) requires each federal banking agency (collectively, the agencies) to establish certain safety-and-soundness standards by regulation or by guideline for all insured depository institutions. Under section 39, the agencies must establish three types of standards: (1) operational and managerial standards; (2) compensation standards; and (3) such standards relating to asset quality, earnings, and stock valuation as they determine to be appropriate.

ii. Section 39(a) requires the agencies to establish operational and managerial standards relating to (1) internal controls, information systems, and internal audit systems, in accordance with section 36 of the FDI Act (12 USC 1831m); (2) loan documentation; (3) credit underwriting; (4) interest-rate exposure; (5) asset growth; and (6) compensation, fees, and benefits, in accordance with subsection (c) of section 39. Section 39(b) requires the agencies to establish standards relating to asset quality, earnings, and stock valuation that the agencies determine to be appropriate.

iii. Section 39(c) requires the agencies to establish standards prohibiting as an unsafe and unsound practice any compensatory arrangement that would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees, or benefits and any compensatory arrangement that could lead to material financial loss to an institution. Section 39(c) also requires that the agencies establish standards that specify when compensation is excessive.

iv. If an agency determines that an institution fails to meet any standard established by guideline under subsection (a) or (b) of section 39, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. In the event that an institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan, the agency must, by order, require the institution to correct the deficiency. The agency may, and in some cases must, take other supervisory actions until the deficiency has been corrected.

v. The agencies have adopted amendments to their rules and regulations to establish deadlines for submission and review of compliance plans.[2]

vi. The following guidelines set out the safety-and-soundness standards that the agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The agencies believe that the standards adopted in these guidelines serve this end without dictating how institutions must be managed and operated. These standards are designed to identify potential safety-and-soundness concerns and ensure that action is taken to address those concerns before they pose a risk to the deposit insurance funds.

A. *Preservation of existing authority.* Neither section 39 nor these guidelines in any way limits the authority of the agencies to address unsafe or unsound practices, violations of law, unsafe or unsound conditions, or other practices. Action under section 39 and these guidelines may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the agencies. Nothing in these guidelines limits the authority of the FDIC pursuant to section 38(i)(2)(F) of the FDI Act (12 USC 1831(o)) and part 325 of title 12 of the Code of Federal Regulations.

B. *Definitions.*

1. In general. For purposes of these guidelines, except as modified in the guidelines or unless the context otherwise requires, the terms used have the same meanings as set forth in sections 3 and 39 of the FDI Act (12 USC 1813 and 1831p-1).

2. *Board of directors,* in the case of a state-

[1] Section 39 of the Federal Deposit Insurance Act (12 USC 1831p-1) was added by section 132 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub. L. 102-242, 105 Stat. 2236 (1991), and amended by section 956 of the Housing and Community Development Act of 1992, Pub. L. 102-550, 106 Stat. 3895 (1992) and section 318 of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325, 108 Stat. 2160 (1994).

[2] For the Office of the Comptroller of the Currency, these regulations appear at 12 CFR 30; for the Board of Governors of the Federal Reserve System, these regulations appear at 12 CFR 263; for the Federal Deposit Insurance Corporation, these regulations appear at 12 CFR 308, subpart R; and for the Office of Thrift Supervision, these regulations appear at 12 CFR 570.

licensed insured branch of a foreign bank and in the case of a federal branch of a foreign bank, means the managing official in charge of the insured foreign branch.

3. *Compensation* means all direct and indirect payments or benefits, both cash and noncash, granted to or for the benefit of any executive officer, employee, director, or principal shareholder, including but not limited to payments or benefits derived from an employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement.

4. *Director* shall have the meaning described in 12 CFR 215.2(c).[3]

5. *Executive officer* shall have the meaning described in 12 CFR 215.2(d).[4]

6. *Principal shareholder* shall have the meaning described in 12 CFR 215.2(*l*).[5]

II. Operational and Managerial Standards

A. *Internal controls and information systems.* An institution should have internal controls and information systems that are appropriate to the size of the institution and the nature, scope, and risk of its activities and that provide for—

1. an organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies;
2. effective risk assessment;
3. timely and accurate financial, operational, and regulatory reports;
4. adequate procedures to safeguard and manage assets; and
5. compliance with applicable laws and regulations.

B. *Internal audit system.* An institution should have an internal audit system that is appropriate to the size of the institution and the nature and scope of its activities and that provides for—

1. adequate monitoring of the system of internal controls through an internal audit function. (For an institution whose size, complexity, or scope of operations does not warrant a full-scale internal audit function, a system of independent reviews of key internal controls may be used.);
2. independence and objectivity;
3. qualified persons;
4. adequate testing and review of information systems;
5. adequate documentation of tests and findings and any corrective actions;
6. verification and review of management actions to address material weaknesses; and
7. review by the institution's audit committee or board of directors of the effectiveness of the internal audit systems.

C. *Loan documentation.* An institution should establish and maintain loan documentation practices that—

1. enable the institution to make an informed lending decision and to assess risk, as necessary, on an ongoing basis;
2. identify the purpose of a loan and the source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner;
3. ensure that any claim against a borrower is legally enforceable;
4. demonstrate appropriate administration and monitoring of a loan; and
5. take account of the size and complexity of a loan.

D. *Credit underwriting.* An institution should establish and maintain prudent credit-underwriting practices that—

1. are commensurate with the types of loans the institution will make and consider the terms and conditions under which they will be made;
2. consider the nature of the markets in which loans will be made;
3. provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed;

[3] In applying these definitions for savings associations, pursuant to 12 USC 1464, savings associations shall use the terms "savings association" and "insured savings association" in place of the terms "member bank" and "insured bank."

[4] See footnote 3 in section I.B.4. of this appendix.

[5] See footnote 3 in section I.B.4. of this appendix.

4. establish a system of independent, ongoing credit review and appropriate communication to management and to the board of directors;
5. take adequate account of concentration of credit risk; and
6. are appropriate to the size of the institution and the nature and scope of its activities.

E. *Interest-rate exposure.* An institution should—

1. manage interest-rate risk in a manner that is appropriate to the size of the institution and the complexity of its assets and liabilities; and
2. provide for periodic reporting to management and the board of directors regarding interest-rate risk with adequate information for management and the board of directors to assess the level of risk.

F. *Asset growth.* An institution's asset growth should be prudent and consider—

1. the source, volatility, and use of the funds that support asset growth;
2. any increase in credit risk or interest-rate risk as a result of growth; and
3. the effect of growth on the institution's capital.

G. [Reserved]

H. [Reserved]

I. *Compensation, fees, and benefits.* An institution should maintain safeguards to prevent the payment of compensation, fees, and benefits that are excessive or that could lead to material financial loss to the institution.

III. Prohibition on Compensation That Constitutes an Unsafe and Unsound Practice

A. *Excessive compensation.* Excessive compensation is prohibited as an unsafe and unsound practice. Compensation shall be considered excessive when amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder, considering the following:

1. the combined value of all cash and noncash benefits provided to the individual;
2. the compensation history of the individual and other individuals with comparable expertise at the institution;
3. the financial condition of the institution;
4. comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets;
5. for postemployment benefits, the projected total cost and benefit to the institution;
6. any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution; and
7. any other factors the agencies determine to be relevant.

B. *Compensation leading to material financial loss.* Compensation that could lead to material financial loss to an institution is prohibited as an unsafe and unsound practice.